WEIL GOTSHAL

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In This Issue

Enactment of the Employee Free Choice Act Will Reshape the Labor Landscape

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Sweeping change in the workplace may be on the horizon if the Employee Free Choice Act ("EFCA") (H.R. 1409, 111th Cong.; S. 560, 111th Cong.) is enacted. The EFCA would amend the National Labor Relations Act ("NLRA") and make it dramatically easier for labor unions to organize employees by circumventing secret ballot elections and obtaining representative certification through a largely unregulated union authorization card check procedure. In addition, the EFCA would enable labor unions more readily to impose their will in collective bargaining for a first contract following certification by requiring binding arbitration if, after 120 days, an employer and the newly certified union fail to come to terms on an initial collective bargaining agreement. Finally, the EFCA would impose significantly increased penalties on employers who unlawfully discharge their employees as a result of their union organizing activities.

Passage of the EFCA is a top priority of organized labor, which views the EFCA as a means of stemming the tide of labor's steadily declining membership and political influence. Since 1983, unions have watched their representation of employees in the private sector fall from approximately 20% to approximately 7.6% today. This sharp decline in union representation is a result of numerous factors, including technological advances, transformation of the US economy from an industrial economy to a white collar, services-based economy, global competition and enactment of a broad array of federal, state and local statutes protecting employees in the workplace, without the need for union representation. Unions, however, attribute their decline to employer tactics permitted under existing laws that serve to delay the National Labor Relations Board ("NLRB") secret ballot election process and the negotiation process leading to a first collective bargaining agreement. Unions also charge that employers routinely terminate union supporters during union organizing drives. They argue that such discharges chill support for unions, and while contrary to existing law, tougher penalties are required in order to deter such violations.

Proposed Changes Under the EFCA

Card Checks Instead of Secret Ballot Elections

Under current law, if an employer refuses to recognize a union voluntarily as the exclusive collective bargaining representative of its employees, a union or employer may petition the NLRB to conduct a secret ballot election. The NLRB will order an election pursuant to a union petition where at least 30% of the workers in a proposed bargaining unit have authorized the union, in writing, to represent them.

Although the required authorizations are commonly in the form of a card indicating an employee's desire to be represented by the union, there is no required form of union authorization.

Employers often refuse a union's request for voluntarily recognition. The union's request for recognition is typically accompanied by the union's offer to furnish an employer with authorization cards signed by a majority of the employer's employees. However, because of uncertainty about the validity of the employees' signatures and the unknown circumstances in which they were obtained, such voluntary recognition is rare. An employer's refusal to recognize a union via a "card check" procedure provides a buffer against potential union misrepresentations, intimidation and other forms coercion, including peer pressure to sign a union authorization card against an employee's will. Further, an employer's insistence on a secret-ballot election provides an employer with an opportunity to communicate with its employees during a pre-election campaign period about its views of the merits of the unions efforts to organize and the best interests of the business and employees. Enactment of the EFCA would change this entire process.

Under the EFCA, if a union presents the NLRB with signatures obtained from a majority of an employer's workers, the NLRB "shall not direct an election but shall certify the individual or labor organization as the representative." This mandate would severely limit an employer's ability to communicate with employees about the desirability of union representation before a collective bargaining relationship is established. In fact, under the EFCA, a union may obtain authorization cards from a majority of an employer's employees before the employer is even aware of any union organizing efforts. Under such circumstances, there would be very little an employer could do to counter misstatements by the union and other inappropriate tactics to obtain surreptitiously union authorization cards.

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Mandatory Binding Arbitration to Impose First Contract

While the demise of the secret ballot election under the EFCA has attracted the most media attention, the legislation contains another equally, if not more dramatic, change to the current labor law framework. Under the EFCA, absent the completion of agreement between an employer and a newly certified union after only 120 days of bargaining, the terms and conditions of employment for the newly represented employees will be set by a government appointed arbitrator in a mandatory binding arbitration. Thus, following a brief and unrealistic time frame within which to reach agreement on a first contract that will set the tone for years to come, a government appointed arbitrator, who may be entirely unfamiliar with an employer's business or industry, will impose the terms that will be binding on the parties for a legislatively required minimum period of two years.

Specifically, under the EFCA, an employer and a union would be required to begin collective bargaining within 10 days after the NLRB certifies the union as the employees' exclusive bargaining representative. If the employer and the union fail to reach an agreement within 90 days, they are given 30 days within which to mediate and reach voluntary agreement under the auspices of the Federal Mediation and Conciliation Service ("FMCS"). If, after mediation, the employer and the union still have not reached an agreement, the FMCS would be required to refer the dispute to an arbitration board to settle the parties' disagreement. The arbitration board's decision would be final and binding on the parties for a period of two years. The EFCA does not establish any standards by which the mandatory arbitration will be conducted or the decision imposed. Such uncertainty will apply enormous pressure on employers to work out an agreement with the union, rather than risk the uncertain result of collective bargaining agreement imposed by a government appointed arbitrator.

The collective bargaining process proposed under the EFCA is a radical departure from current law, under which neither party is required to agree to specific terms and the government may not impose specific terms.

Increased Penalties for Unfair Labor Practices

Adding another arrow to organized labor's organizing quiver, the EFCA would triple the back pay damages that could be imposed for presently unlawful terminations as a result of union activity, when such terminations take place during the union's organizing campaign or during the period in which a first collective bargaining agreement is being negotiated. In addition, a new civil penalty of $20,000 may be imposed for each "willful" violation.

Political Climate

The EFCA was re-introduced in both the House of Representatives and the Senate on March 10, 2009. Proponents of the EFCA, including labor unions and economists, tout the bill as a necessary element of the economic stimulus required to protect jobs and stem the rising wave of unemployment in the US. But many dispute the wisdom of the EFCA, arguing that by effectively eliminating the secret-ballot option,[1] Congress will mark open season for unions to intimidate and coerce workers to join them. Moreover, critics fear that employees who realize they were bullied or tricked into joining a union will have no way to decertify the union, as the employer will have been forced into a binding, two year contract after only 120 days. While proponents of the bill argue that the interest arbitration provision of the EFCA would facilitate collaborative and speedy bargaining between unions and management, businesses are opposed to government appointed arbitrators (with potentially little to no experience in the employer's industry) mandating the terms and conditions of their workers' employment. Some economists also worry that instead of protecting or creating jobs, the bill would have the opposite effect, increasing unemployment by driving small employers unable to support unionization out of business. Interest groups on both sides of the issue have already expended millions of dollars to garner support for their respective positions. Such expenditures are expected to continue until the House and Senate come to a vote on the bill.

Both President Obama and Vice President Biden have expressed unwavering support for the EFCA, most recently, in their remarks made earlier this month to AFL-CIO leaders gathered in Miami. The legislation is expected to sail through the House of Representatives, where, in 2007, it passed by a vote of 241–185, with 13 Republicans voting in its favor. The Democratic leadership in the House, which gained 21 seats after the 2008 election, has reportedly agreed to delay a vote on the EFCA until the Senate has acted. It is clear that the real debate will be waged on the Senate floor, where in 2007 the EFCA fell nine votes short of the 60 needed to survive a GOP filibuster.

The collective bargaining process proposed under the EFCA is a radical departure from current law under which neither party is required to agree to any specific terms and the government may not impose any terms.

Following the 2008 elections, when the Democrats gained eight seats in the Senate (totaling 58 seats, with one seat in Minnesota still undecided), the EFCA was originally predicted to garner enough votes to overcome a filibuster and pass. But recently, many issues have arisen that could complicate matters. Five business-oriented Democrats who voted for cloture in 2007 have stated they may change their position on the EFCA, which one Democrat labeled as divisive and distracting during the current economic crisis. Al Franken, an outspoken supporter of the EFCA, still remains to be seated while a court decides Republican Senator Norm Coleman's challenge to the results of the Minnesota recount. Senator Ted Kennedy, who sponsored the 2007 bill and is the Chair of the Senate Committee on Health, Education, Labor and Pensions, has had well-publicized health problems and may not be well enough to participate in a vote. Finally, there remains controversy surrounding the seating of Democratic Illinois Senator Roland Burris, although Burris has not publicly supported the EFCA and in fact was recently criticized by labor for not taking a strong stance in support of the EFCA. With this much uncertainty on their side of the aisle, Senate Democrats will surely focus on persuading Republicans to support the bill. Doing so will not be an easy task, as even Senator Arlen Spector, the only Republican who supported a vote on the EFCA in 2007, is now wavering due to heavy pressure from lobbyists. Add to this the fact that some Senators in 2007 may have considered an affirmative vote a "free pass" to gain favor among certain constituents – aware that President Bush would veto the bill – and it is by no means guaranteed that the EFCA will come to a vote.

Competing Legislation

Since the EFCA's failed 2007 run through the Senate, Congressional Republicans have not sat by idly waiting for the bill's reintroduction. On February 25, 2009, Representative John Kline introduced the "Secret Ballot Protection Act," H.R. 1176, 111th Cong. On the same day, Senator Jim DeMint introduced the "Secret Ballot Protection Act of 2009," S. 478, 111th Cong. Both bills are preemptive measures targeted directly at the EFCA with the stated purpose of "amend[ing] the National Labor Relations Act to ensure the right of employees to a secret-ballot election conducted by the National Labor Relations Board." The proposed legislation seeks to protect the secret ballot election by making it an unfair labor practice for an employer to recognize or bargain with a union that has not been certified through a secret ballot election and for a union to attempt to cause an employer to recognize or bargain with such a union. Unfortunately, the Secret Ballot Protection Act confirms that Congressional Republicans have, like much of the media, focused primarily on the EFCA's card check provision, while paying much less attention to the equally, if not more, troublesome mandatory interest arbitration requirements.

While there remains considerable uncertainty about whether the EFCA will pass, and if so, in what form, employers must be ready to act if and when the labor law landscape that has existed unchanged for 70 years shifts beneath their feet.

Democrats have also very recently introduced more moderate legislation to compete with the EFCA. On March 5, 2009, at a time during which there was intense focus on the impending re-introduction of the EFCA, Democratic Representative Joe Sestak introduced the National Labor Relations Modernization Act ("NLRMA") (H.R. 1355, 111th Cong.). The NLMRA offers several alternatives to the EFCA. First, rather than eliminating secret ballot elections, it would require that, during an election campaign, an employer notify the union about any opposition activities in which it intends to engage, such as holding meetings, making announcements, displaying signs, or distributing literature to employers. Second, during the campaign, an employer would be required to provide the union with equal access to the workplace to engage in the same type of activity. Next, the NLRMA would limit the mandatory arbitration requirement to employers with 20 or more employees, would extend the parties' time to negotiate freely from 90 days to 120 days, and would extend the subsequent mediation period from 30 days to 120 days. Finally, a first agreement achieved through arbitration under the NLRMA would be binding for 18 months, rather than the 2 years required under the EFCA. The NLRMA had no co-sponsors, and it remains to be seen whether Democrats who are wavering in their support for the EFCA will consider this new bill as a viable compromise.

Advice For Employers

Employers have cause to be concerned about this proposal to make sweeping changes to the labor laws that have been in place for the past 70 years. Employers would be well advised to take preemptive and proactive measures to prepare for the EFCA's changes.

- ***Develop a plan.*** Designate a team to monitor developments in the legislative process, provide updates to management, and develop a written response plan.
- ***Review and revise policies now.*** Review any policies, handbooks, or manuals that deal with issues of labor relations to ensure compliance. Consider promulgating anti-solicitation/anti-distribution rules. Be vigilant to ensure that policies and those enforcing such policies treat employees fairly and respectfully. Ensure that lines of communication with rank and file employees remain open and that managers are responsive to employee concerns. Establish and maintain a positive working environment.
- ***Train supervisors, middle managers and senior executives.*** Educate supervisors, managers and senior executives about labor laws and penalties, as well as the true costs of union membership (initiation fees, dues, assessments, fines) and the effects of union rules on the workplace. Train supervisors to recognize subtle signs of union organizing: employees meeting secretively in groups in parking lots or break rooms; a sudden increase in questions regarding employee rights and grievance procedures; and/or a surge in workplace complaints.
- ***Train employees.*** Educate employees regarding card check procedures and elections, and the risk of signing anything without fully understanding the purpose of what they are signing. Although the common method for obtaining employee authorizations is by using a "card," there is no required form of authorization. Educate employees about why a union is an unnecessary third party in the employer-employee relationship. Stress the positive aspects of the workplace and the terms and conditions of employment.
- ***Develop a plan for arbitration.*** If compelled to arbitrate within only four months of a union certification, an employer will need to be in position to best present its case to the arbitrator. Develop a plan now, including identifying those persons who will be responsible for the arbitration, identifying the terms and conditions of employment that will likely be contested in arbitration and the evidence that will be presented to support the employer's position.

While there remains considerable uncertainty about whether the EFCA will pass, and if so, in what form, employers must be ready to act if and when the labor law landscape that has existed unchanged for 70 years shifts beneath their feet.

1 Technically, under the EFCA, employers could still resort to the secret ballot process, but only in circumstances in which the union petitions the NLRB with authorizations from more than 30 but less than 50 percent of the workers.

The Lilly Ledbetter Fair Pay Act of 2009

By Patricia Wencelblat

On January 29, 2009, President Obama signed into law his first piece of legislation: the Lilly Ledbetter Fair Pay Act of 2009 ("the Act"). The Act overturned the Supreme Court's decision in *Ledbetter v. Goodyear Tire & Rubber Co.*, 550 U.S. 618, 127 S.Ct. 2162 (2007), which held that the statue of limitations for compensation discrimination claims begins to run on the date of the discriminatory pay decision. The Act codifies the so-called "paycheck rule" under which each paycheck that continues to reflect disparate pay levels restarts the limitations period, even if the employer's allegedly discriminatory practice, which resulted in the lower pay, occurred before the limitations period. The statute is expected to increase individual filings and class actions, not only because of the relaxed applicable statute of limitations, but also because the publicity surrounding this legislation likely will encourage some employees – who might otherwise not have done so – to bring pay discrimination claims. As a result, employers now face the daunting task of defending stale claims long after documents have been misplaced or discarded and the lead decision-makers are no longer available. This article summarizes the Act, details its implications and possible interpretations, and provides suggestions for employers on steps to take in light of its revisions to Title VII.

The key change under the Act is that the receipt of a paycheck that is lower because of a past discriminatory compensation decision or other practice – even if that compensation decision or other practice occurred well before the limitations period – restarts the statute of limitations clock.

Background: *Ledbetter v. Goodyear Tire & Rubber Co.*

The Supreme Court in *Ledbetter* ruled that employees must file pay discrimination claims within the normal 180/300 day statute of limitations from the employer's original decision to pay them less – even if the employee received paychecks during the limitations period that continued to reflect the employer's decision to pay less. The plaintiff, Lilly Ledbetter, was employed as a manager at a Goodyear plant from 1979 until 1998, and throughout that time her salary increases were based on performance evaluations she received from her supervisors.[1] She introduced evidence that, during the course of her employment, several supervisors gave her poor evaluations because of her sex, that as a result of these evaluations her pay was not increased as much as it would have been if she had been evaluated fairly, and that these discriminatory evaluations resulted in her being paid less in each pay cycle during the applicable limitations period.[2] The jury found for Ledbetter and awarded her back pay and damages.[3] Goodyear appealed this decision to the Eleventh Circuit Court of Appeals, contending that Ledbetter's claims with respect to discriminatory decisions made before the 180-day limitations period were time barred, and that she had asserted no claim based on discrimination in pay during the limitations period.[4] The Eleventh Circuit reversed and Ledbetter appealed to the Supreme Court.

The Supreme Court affirmed the Eleventh Circuit's decision, and held that a pay-setting decision is a "discrete act" such as termination, hiring, and promotion, thus triggering the start of the 180-day statute of limitations.[5] The Court rejected Ledbetter's argument that each paycheck affected by past discriminatory decisions constituted an unlawful employment practice that restarted the statute of limitations clock.[6] The Court "reject[ed] the suggestion that an employment practice committed with no improper purpose and no discriminatory intent is rendered unlawful nonetheless because it gives some effect to an intentional discriminatory act that occurred outside the charging period."[7]

Justice Ginsberg's Dissent

In a strongly-worded dissent that she read from the bench, Justice Ginsberg urged Congress to overturn the Supreme Court's decision. Justice Ginsberg argued that pay disparities are significantly different from adverse actions such as termination, promotion, and hiring because pay disparities often occur in small increments, and it is only after the passage of time, once the disparity becomes obvious and significant, that an employee will complain.[8] Justice Ginsberg argued that "the unlawful practice [under Title VII] is the current payment of salaries infected by gender-based (or race-based) discrimination," and invited Congress to overturn the Court's "cramped" interpretation of Title VII.[9]

The Lilly Ledbetter Fair Pay Act

The Lilly Ledbetter Fair Pay Act, introduced by Senator Barbara Mikulski

(D-MD) makes legislative findings, stating that the Supreme Court's decision "significantly impairs statutory protections against discrimination in compensation . . . by unduly restricting the time period in which victims of discrimination can challenge and recover for discriminatory compensation decisions or other practices . . . and ignores the reality of wage discrimination." The Act amends Title VII to overturn the Supreme Court's decision in *Ledbetter*, and amends the Age Discrimination in Employment Act (ADEA), the Americans with Disabilities Act (ADA), and the Rehabilitation Act of 1973 in the same manner as the amendment to Title VII. The effective date of the Act is May 28, 2007, the date before the Supreme Court's decision, making its applicability retroactive to all claims pending on or after that date.

In Section 3, the Act defines "an unlawful employment practice" in violation of Title VII as:

> (1) when a discriminatory compensation decision or other practice is adopted;
>
> (2) when an individual becomes subject to a discriminatory compensation decision or other practice; or
>
> (3) when an individual is affected by application of a discriminatory compensation decision or other practice, including each time wages, benefits, or other compensation is paid, resulting in whole or in part from such a decision or other practice.

Thus, the key change under the Act is that the receipt of a paycheck that is lower because of a past discriminatory compensation decision or other practice – even if that compensation decision or other practice occurred well before the limitations period – restarts the statute of limitations clock. However, the Ledbetter Act does not alter the period of recovery allowed by Title VII, which remains at two years of back pay from the date the employee files a charge of discrimination.

Proposed Amendments to the Ledbetter Bill

Various amendments were introduced in the Senate to clarify and/or limit the scope of the Act, none of which passed. For example, Senator Kay Bailey Hutchinson (R-TX) introduced an amendment (S. Amdt. 25) as a substitute bill that would have imposed the common law discovery rule for a "reasonable person who exercises due diligence regarding the person's rights but who did not have, and should not have been expected to have, a reasonable suspicion that the person was the object of unlawful discrimination."[10] Under the Amendment "[s]uch a person should be afforded the full applicable limitation period to commence a claim from the time the person has, or should be expected to have, a reasonable suspicion of discrimination."[11] Senator Mikluski argued that the "should have known" standard imposed by Senator Hutchinson's amendment would unduly burden plaintiffs by forcing them to prove a negative, and would lead to protracted litigation. Senator Hutchinson's amendment was defeated by a vote of 55-40.

Senator Arlen Specter (R-PA) introduced an amendment (S. Amdt. 27) that would have struck the words "other practice" from Section 3 of the Act and would have specified that the Act was aimed exclusively at compensation discrimination claims. Senator Specter argued that the Act did not include a definition for "other practice," so it could be interpreted to include hiring, transfer, promotion, training, work assignment, discipline or demotion.[12] Senator Mikulski responded that under Senator Specter's proposed amendment, the situation encountered by Ledbetter, where her pay was tied to her performance evaluation, would no longer be covered by the Act, and therefore, the Act must take into account the reality that salary determinations are often based on other acts that could be discriminatory.[13] Senator Mikluski contended that the bill specifically addresses discrimination in compensation, which provides sufficient limiting language.[14] A motion to table the amendment was agreed to by a vote of 55-39.

Senator Mike Enzi (R-WY) introduced two amendments to clarify standing (S. Amdts. 28 and 29). The Senator noted that the Act could expand the class of persons who have standing to sue under Title VII beyond those who have been discriminated against to any individual who is "affected by" the discrimination, which could include spouses, family members, or other individuals dependent on the employee's income or pension.[15] Senator Mikulski assured Senator Enzi that in amending Title VII, the ADEA, and the ADA, the Act would clearly not expand the class of plaintiffs beyond those subjected to discrimination in employment.[16] Senator Mikulski further elaborated that she was making it "crystal clear" and stating "unabashedly for legislative intent ... that the only persons who can file a suit under the act of discussion today are those who have suffered discrimination on the job or the Federal entities charged with enforcing these civil rights acts, not the relatives or friends of these workers."[17] A motion to table Amendment 28 was agreed to by a vote of 55-41, and a motion to table Amendment 29 was agreed to through a voice vote.

Interpretations of the Ledbetter Fair Pay Act

Both the plaintiff and defense bar have begun to speculate as to the effects of the Ledbetter Fair Pay Act, with lawyers on both sides highlighting the potential for courts to take an expansive reading of the legislation. For example, as highlighted by Senator Specter, litigants may debate whether the "other practice" language in the Act relaxes the statutes of limitations on a number of employment practices that impact compensation, including practices with respect to promotions, demotions, and performance reviews. Plaintiffs may seek to argue years or even decades later that a claim of reduced pay as a result of such practices could be kept "alive" either by the receipt of a paycheck with the effects of the decision still present, or the first payment of a retiree benefit calculated based on pay that was less than it would have been but for an allegedly discriminatory employment practice. Consequently, while Senator Mikulski indicated during floor debates that this language was intended to apply only to direct inputs into compensation decisions, such as performance evaluations, and not to other discrete acts of discrimination, plaintiffs may ask courts to blur the line between a direct input into compensation, and other practices that may affect an employee's compensation.[18]

Given Senator Mikulski's statement, defendants certainly will argue in future cases that the Act does not overturn *United Airlines, Inc. v. Evans*, 431 U.S. 553 (1977), which held that discrete acts that occurred before the limitations period are not actionable. Under the Act, the payment of a paycheck that is lower because of a past discriminatory action is the discriminatory act at the heart of the claim, not the original discriminatory decision that led to the difference in compensation. Thus, one can argue that the Act does not technically "revive" that original claim, but rather allows a plaintiff to bring a compensation claim for any resulting pay differential during the applicable limitations period if that pay differential is the product of past discrimination. Furthermore, the Act does not foreclose an employer from asserting that an employee's claim is barred under the equitable doctrines of waiver, estoppel, or laches.[19]

Implications For Employers

Because the Ledbetter Fair Pay Act restricts the statute of limitations defenses that previously had been available to employers and may generate a wave of compensation discrimination lawsuits, there are certain steps employers should take to reduce the risk of and aid in the defense of such lawsuits. As a result of the Act, stale claims based on discriminatory compensation decisions or other practices that occurred many years ago may now be revived, long after key decision-makers are gone or memories have faded. Alternatively, operative documents that might shed light on the decision-making process may have been misplaced or purged pursuant to applicable company retention policies. While employees clearly will face hurdles in proving allegedly discriminatory actions that transpired years earlier, experience suggests that "retrieving" a company's institutional memory so many years later may present greater obstacles for the employer, absent improved contemporaneous measures to capture and preserve the decision-making process.

As a result of the Act, stale claims based on discriminatory compensation decisions or other practices that occurred many years ago may now be revived, long after key decision-makers are gone or memories have faded.

- Employers should review recordkeeping and document retention practices with respect to employment decisions documenting the legitimate non-discriminatory reasons for such decisions that may arguably provide a basis for future decisions with respect to employees' pay. Employers should adopt procedures to maximize the likelihood that material records will exist and remain available for review after a supervisor or manager responsible for the allegedly discriminatory employment decision is no longer available, *i.e.*, create an institutional memory that captures the basis for key employment decisions that may be used by future plaintiffs as a basis from which to argue for an inference of pay discrimination.
  - This may significantly alter a company's prior practice of retaining such documents only until the applicable statutory limitations period has expired, which itself may have cost implications with regard to electronic and paper document storage, which must be balanced against the economic risk of not having the necessary records to defend a claim.
  - While it would be impossible for an employer to document every conceivable employment decision on which a plaintiff may rely in the future, employers should maximize the likelihood that material decisions involving hiring, compensation, promotion and complaint resolution are reduced to writing.
- Employers might consider periodic auditing of current compensation levels and analysis of compensation data to determine if any surface

disparities exist that may form the basis for plaintiffs to argue that such disparities are the result of discrimination.

- Employers should review compensation decisions and criteria to ensure that they can justify their employment practices with legitimate business justifications. The review should include an analysis of current policies and practices with regard to controls, guidelines, and discretionary limits on line managers and human resources personnel in establishing starting salaries, and in determining merit raises and salary increases associated with promotions. Companies also may wish to study the extent of managerial adherence to or variance from extant guidelines and policies.
- Employers should advise and train all managers on anti-discrimination laws, including the Ledbetter Act, to ensure that all compensation decisions are based on current, non-discriminatory criteria.

1 *Id*. at 2165.

2 *Id*. at 2165-66.

3 *Id*. at 2166.

4 *Id*.

5 *Id*. at 2175, 2188.

6 Ledbetter relied on *Bazemore v. Friday*, 478 U. S. 385 (1986), in which the Court stated that "[e]ach week's paycheck that delivers less to a black than to a similarly situated white is a wrong actionable under Title VII." *Id*. at 395. Prior to the *Ledbetter* decision, some practioners had assumed this statement by the Supreme Court had already answered the question at issue; however, given the different context of the *Bazemore* decision, *i.e*., the fact the employer had a facially discriminatory pay structure that had been in place pre-Title VII and which it maintained post-Title VII, the Court in Ledbetter stated that it was not overturning *Bazemore*. *See Ledbetter v. Goodyear*, 127 S.Ct. at 2173. Rather, the Court held that the *Ledbetter* decision was controlled by *United Airlines v. Evans*, 431 U.S. 553 (1977) and *Delaware State College v. Ricks*, 449 U.S. 250 (1980).

7 *Id*. at 2172.

8 *Id*. at 2178-79 (Ginsberg, J. dissenting).

9 *Id*. at 2179.

10 155 Cong. Rec. S5188 (daily ed. Jan. 21, 2009) (statement of Sen. Kay Bailey Hutchinson).

11 *Id*.

12 155 Cong. Rec. S697 (daily ed. Jan. 21, 2009) (statement of Sen. Arlen Specter).

13 155 Cong. Rec. S757 (daily ed. Jan. 22, 2009) (statement of Sen. Barbara Mikulski).

14 *Id*.

15 155 Cong. Rec. S749 (daily ed. Jan. 22, 2009) (statement of Sen. Mike Enzi).

16 155 Cong. Rec. S751 (daily ed. Jan. 22, 2009) (statement of Sen. Barbara Mikulski).

17 *Id*.

18 Likewise, despite some speculation that the "affected by" language could expand the types of plaintiffs who have standing to bring Title VII claims beyond employees subjected to discrimination, as noted by Senator Mikulski, the Act amends the statute of limitations section of Title VII, but does not change the class of persons who have standing to bring file a charge of discrimination. *See* Ledbetter Fair Pay Act of 2009 Becomes Law, Jackson Lewis at (http://www.jacksonlewis.com/legalupdates/article.cfm?aid =1616) ("This broad language could sanction pay discrimination charges filed by non-employees, such as the spouses of deceased workers, so long as those individuals claim they have been affected by the discriminatory practice."); *see also* Section 706(b) of Title VII, 42 U.S.C § 2000e-5(b) (authorizing the EEOC to accept charges of employment discrimination "filed by or on behalf of a person claiming to be aggrieved" by employment discrimination).

19 155 Cong. Rec. S754 (daily ed. Jan. 22, 2009) (statement of Sen. Mikulski).

The New Scope of Title VII's Anti-Retaliation Provision

By Gary D. Friedman and Emily E. Friedman

In a decision that may impact how employers conduct internal investigations, the U.S. Supreme Court clarified the scope of the anti-retaliation provision under Title VII[1] to include protection of those employees "who speak[] out about discrimination not on [their] own initiative, but in answering questions during an employer's internal investigation."[2] In *Crawford v. Metro. Gov't of Nashville & Davidson County*, the Court addressed the question of how far Title VII's anti-retaliation provision stretched in the context of an employer's internal investigation. The Court held that even though an employee did not initiate a complaint of discrimination, disapproving statements made by that employee in response to her employer's internal investigation were nonetheless covered by the "opposition clause" of Title VII. This article discusses the *Crawford* decision and its impact, and raises some issues for employers to consider in preparing for and conducting internal investigations of discrimination or harassment.

Background

Title VII prohibits retaliation by employers against employees who report, among other things, workplace race or gender discrimination. Specifically, Section 704(a) of the anti-retaliation provision of Title VII makes it unlawful for an employer to discriminate against any employee who (1) "has opposed any practice made an unlawful employment practice by [Title VII]" ("opposition clause") or (2) "has made a charge, testified, assisted, or participated in any manner in any investigation, proceeding, or hearing under [Title VII]" ("participation clause").[3] In *Crawford*, plaintiff/petitioner Vicky Crawford alleged that her employer, defendant/respondent Metropolitan Government of Nashville and Davidson County, Tenn. ("Metro"), violated both the "opposition clause" and the "participation clause" when it terminated her employment in retaliation for her having conveyed certain comments and conduct by her supervisor, Gene Hughes, in response to questions posed by an internal investigator.

Of significance in the case, Crawford did not initiate Metro's investigation against Hughes, nor had she complained previously of the harassing behavior that led to the internal investigation. However, when Metro's human resources officer, who was conducting the internal investigation, asked Crawford in the course of that investigation whether she had witnessed any "inappropriate behavior" on Hughes' part, Crawford responded by describing several instances of such behavior.[4] Crawford explained that once, her supervisor had answered her greeting of "Hey Dr. Hughes, what's up?" by grabbing his crotch and saying "You know what's up."[5] Crawford also reported that her supervisor had repeatedly "put his crotch up to [her] window," and on another occasion, had entered Crawford's office and "grabbed her head and pulled it to his crotch."[6]

Shortly after the investigation, Metro fired Crawford for embezzlement. Metro took no action against Crawford's alleged harasser. Crawford then filed an EEOC charge, and later initiated a federal Title VII action against Metro for retaliation, arguing that her responses to Metro's questions during the investigation constituted protected activity under Title VII's anti-retaliation provision.

Procedural History

The District Court granted Metro's motion for summary judgment and dismissed Crawford's claim that Metro violated both the opposition and participation clauses of Title VII. In doing so, the Court found that Crawford "could not satisfy the opposition clause because she had not 'instigated or initiated any complaint,' but had 'merely answered questions by investigators in an already-pending internal investigation, initiated by someone else.'"[7] The Court also found that Crawford's claim failed under the participation clause, which was confined to protecting "an employee's participation in an employer's internal investigation . . . where that investigation occurs pursuant to a pending EEOC charge."[8] The Sixth Circuit affirmed the dismissal of Crawford's federal retaliation claim on the same grounds, reasoning that Crawford's conduct was "not the kind of overt opposition . . . required for protection under Title VII."[9]

Rejecting the Sixth Circuit's view of the opposition clause, the Supreme Court interpreted the word "oppose" to encompass more than just "active, consistent" behavior.

Because the Sixth Circuit's interpretation of the anti-retaliation provision under Title VII conflicted with those of other Circuits, particularly as to the opposition clause, the Supreme Court granted Crawford's petition for certiorari.[10]

The Supreme Court's Decision

Rejecting the Sixth Circuit's view of the opposition clause, the Supreme Court interpreted the word "oppose" to encompass more than just "active, consistent" behavior. Because Title VII left the term "oppose" undefined, the Court applied the verb's dictionary definition: "to resist or antagonize . . . ; to contend against; to confront; resist; withstand."[11] In doing so, the Court concluded that "there is . . . no doubt that a person can 'oppose' by responding to someone else's question just as surely as by provoking the discussion, and nothing in the statute requires a freakish rule protecting an employee who reports discrimination on her own initiative but not one who reports the same discrimination in the same words when her boss asks a question."[12] Thus, the Court held that Crawford's statements were "an ostensibly disapproving account of sexually obnoxious behavior toward her by a fellow employee" and were protected under the opposition clause.[13]

In reaching its decision, the Court also looked to an EEOC guideline which explained, "[w]hen an employee communicates to her employer a belief that the employer has engaged in . . . a form of employment discrimination, that communication [virtually always] constitutes the employee's *opposition* to the activity."[14] The guideline supported the Court's conclusion that the disapproving statements Crawford made during the internal investigation about her supervisor's behavior would certainly qualify in the minds of reasonable jurors as sufficient to fall within the ambit of the opposition clause.

Significantly, the Court did not address the participation clause because the Court found convincing Crawford's argument that her activity was protected by the opposition clause.

Crawford's Impact On The Faragher-Ellerth Defense

Under the *Faragher-Ellerth* affirmative defense, an employer can escape liability for a supervisor's sexual harassment of an employee when it can prove that (1) a tangible employment act, such as discharge, demotion, or undesirable job reassignment was not involved, (2) reasonable care was taken to prevent and promptly correct the harassment, and (3) the plaintiff-employee failed unreasonably to take advantage of the preventative or corrective opportunities offered or otherwise avoid harm.[15] The seminal *Faragher* and *Ellerth* decisions have incentivized employers to conduct internal investigations of workplace discrimination.

In *Crawford*, Metro argued if the Court expanded protection of Title VII, employers would have less incentive under the *Faragher-Ellerth* decisions to actively investigate possible claims of workplace harassment. Specifically, Metro and its *amici* argued that should the Court "lower the bar for retaliation claims," employers would be less likely to conduct internal investigations.[16]

Rejecting this argument, the Court reinforced the importance of the *Faragher-Ellerth* scheme, finding "it hard to see why the Sixth Circuit's rule would not itself largely undermine" the affirmative defense. For instance, as the Court pointed out, if the law were clear that an employee who reported discrimination could be penalized without any remedy, prudent employees would have no reason to be forthcoming during internal investigations and would "keep quiet about Title VII offenses."[17]

Questions Raised By *Crawford* And Next Steps For Employers

The *Crawford* decision left open the crucial question of just how far Title VII's anti-retaliation protection stretches. The majority decision noted, in dicta, that the definition of "oppose" could also include "to be hostile or adverse to, *as in opinion*."[18] In his concurring opinion, Justice Alito highlighted the dilemma that such a broad interpretation of "oppose" could create in the Title VII context. Such an interpretation would expand Title VII protection to those employees who express what Justice Alito described as "silent opposition" to workplace discrimination.[19] For instance, those employees who have private conversations at the "proverbial water cooler" may now be able to invoke Title VII protection if their employer were to subsequently take an adverse employment action against them. Justice Alito also warned that "an expansive interpretation of protected opposition conduct" would likely cause an increase in retaliation charges filed with the EEOC.[20]

The *Crawford* decision left open the crucial question of just how far Title VII's anti-retaliation protection stretches.

Although Justice Alito viewed the majority decision as limiting an employee's "opposition" to circumstances where the employee testifies in an internal investigation or engages in "other analogous purposive conduct,"[21] it remains unclear whether *Crawford* would afford protection to an employee who simply expressed his or her views of a coworker's actions in other circumstances such as a casual conversation with coworkers. Such employee can later allege that he or she expressed opposition, even though he or she never made such statements to an employer. As Justice Alito noted, such employees "might well be able to create a genuine factual issue on the question of causation."[22] Thus, when coupled with the Supreme Court's decision in Burlington Northern, *Crawford* will likely make obtaining summary judgment more challenging.[23]

Consider, for example, if Crawford had, instead, made the following comment to the human resources officer during a casual lunch encounter: "Dr. Hughes often compliments women on their appearance." A number of questions are raised by this hypothetical, including, whether Crawford expressed any sort of disapproval of Hughes' alleged conduct, and whether such a statement to the human resources officer constituted "opposition" under Crawford's parameters. Subsequent cases likely will be confronted with the question of when an employee's expression of dissatisfaction about workplace conduct is sufficient to trigger protection under the opposition clause.

Because employers are obligated to ferret out and put a stop to discrimination and harassment in the workplace, conducting thorough internal investigations remains essential. But, given the Court's widening view of Title VII's anti-retaliation provisions, employers will need to evaluate more carefully than before the potential breadth of their internal investigations, including whom to interview and the scope of those interviews. For example, employers may need to be more selective in whom they choose to interview, focusing on those who may have first hand knowledge of relevant events. With respect to the scope of the investigation, employers should be aware of the risks associated with a "no stone unturned" approach to an investigation which may lead down blind alleys and create fodder for potential future claims of retaliation.

In addition, employers should actively train human resources personnel and other supervisory-level managers who conduct internal investigations to make sure employees conduct investigations in compliance with the contours fashioned by *Crawford*. For instance, employers should train those individuals conducting the investigation to clearly advise witnesses of the employer's anti-retaliation policy. Employers should instruct those employees who conduct the investigations to carefully document the results of such investigations and the testimony of the employees they interview. Depending upon the circumstances, such documentation might also contain commentary on the witness's demeanor and conduct during the interview. An investigator's detailed notes may alleviate the need for witness statements – which often present downsides of their own – including the danger that a witness statement does not accurately capture the totality of the interview, and the potential for witness intimidation. Employers also should consider instructing those individuals conducting internal investigations to ask witnesses open-ended questions (as opposed to leading questions) in order to ascertain whether a witness is actually expressing disapproval of a coworker or supervisor's conduct. Broad questions such as "What did you see?," "What did you do?" and "How did you feel?" are more likely to elicit a witness's true feelings about the conduct that he or she observed.

Finally, employers are strongly encouraged to implement and disseminate a "zero-tolerance" anti-retaliation policy and ensure that such policies are implemented in a non-discriminatory fashion. Similarly, employers must be careful to follow up and investigate claims of discrimination and harassment made by employees during the course of an internal investigation, regardless of whether the complaining employee initiated the complaint.

1 Title VII of the Civil Rights Act of 1964, as amended, 42 U.S.C. § 2000e et seq.

2 *Crawford v. Metro. Gov't of Nashville & Davidson County, Tenn.*, 129 S. Ct. 846, 849 (2009).

3 42 U.S.C. § 2000e-3(a).

4 *Crawford*, 129 S. Ct. at 849.

5 *Id.*

6 *Id.*

7 *Id.* at 850 (citations omitted).

8 *Id.*

9 *Crawford v. Metro. Gov't of Nashville & Davidson County, Tenn.*, 211 Fed. Appx. 373, 376 (6th Cir. 2006), *rev'd and remanded*, 129 S. Ct. 846 (2009).

10 128 S. Ct. 1118 (2008).

11 *Crawford*, 129 S. Ct. at 850.

12 *Id.* at 851.

13 *Id.* at 850.

14 *Id.* at 851 (citing 2 EEOC Compliance Manual §§ 8-II-B(1), (2), p. 614:0003 (March 2003)).

15 *See Faragher v. Boca Raton*, 524 U.S. 775 (1998) and *Burlington Indus. Inc. v. Ellerth*, 524 U.S. 742 (1998).

16 *Crawford*, 129 S. Ct. at 851-852.

17 *Id.* at 852.

18 *Id.* at 850 (emphasis added).

19 *Id.* at 854 (J. Alito, concurring).

20 *Id.* at 855 (J. Alito, concurring) (citing the EEOC's website).

21 *Id.* at 853 (J. Alito, concurring).

22 *Id.* at 854 (J. Alito, concurring).

23 *See Burlington Northern & Sante Fe Railway v. White*, 548 U.S. 53 (2006) (holding that Title VII prohibits adverse employment actions against employees in retaliation for complaints of discrimination, even when the challenged action is something less than a termination).

Workforce Reductions May Provide Fertile Ground for "Cat's Paw" Bias Claims

By Mark A. Jacoby and Daniel J. Venditti

The global economic downturn has affected virtually every industry in America. News breaks daily of companies implementing workforce reductions impacting hundreds and even thousands of workers at a time. WARN Act claims, wage and hour actions, and ERISA 401(k) plan stock-drop litigation have surged in recent months. Although much recent media attention has focused on the increase in these types of employment claims, employers engaged in workforce reductions must recognize that a reduction in force ("RIF") also can give rise to claims of employment discrimination. In these hard times, as much as ever, employers must assess and manage risks associated with adverse employment actions. Displaced workers now have fewer options to quickly reenter the workforce, which could increase their willingness to pursue litigation.

For larger employers, personnel decisions often are made by employees who are separated – either geographically or by multiple levels of staffing – from the workforce. Under these circumstances, adverse employment actions often will be based on recommendations or information received from subordinate supervisory employees who themselves lack the authority to make significant employment decisions. These subordinate supervisory employees often are best able to provide necessary information for the decision makers because they typically interact directly with the workers.

What would be the result for the employer if a subordinate employee responsible for recommending relevant criteria for a RIF, or rating employees according to RIF criteria specified from above, did so motivated by a desire to ensure that older workers, women, or other protected classes are included in the RIF? As discussed below, it has been the general rule of employment discrimination law that if the subordinate employee had no authority to make the final RIF decision, and the actual decision maker did not know of the subordinate's discriminatory intent, the employer would not be liable. But that is not always the case, and employers large and small must be cautious not to place too much reliance on information provided by subordinate employees.

Cat's Paw Liability

Title VII defines "employer," in relevant part, as "a person engaged in an industry affecting commerce . . . and any agent of such person."[1] The Age Discrimination in Employment Act ("ADEA") similarly extends employer liability to cover the acts of an employer's "agents."[2] Under general agency principles, an agent of an employer is someone authorized by the employer to act on its behalf, i.e., to give effect to employment decisions. Therefore, in most cases, liability for an alleged discriminatory adverse employment action, such as a termination, will exist for an employer only when (1) the person who carried out the adverse employment action had the authority to do so; and (2) that person did so based upon improper considerations of age, gender, race, national origin, or other impermissible criteria.

There are circumstances, however, in which an employer can be held liable for employment discrimination even if the person with the ultimate responsibility for the challenged decision did not act for inappropriate reasons. This could happen if the decision making process was tainted to some degree by the discriminatory motives of a subordinate supervisory employee.

This theory is often referred to as the "cat's paw" – or "subordinate bias" – theory of liability, and is a well recognized exception to the general rule described above. The term "cat's paw" is derived from the seventeenth century fable *The Monkey and the Cat*, "in which a monkey convinces an unwitting cat to pull chestnuts from a hot fire. As the cat scoops the chestnuts from the fire one by one, burning his paw in the process, the monkey eagerly gobbles them up, leaving none for the cat."[3] The phrase now is used to refer to a situation in which a person uses someone else to accomplish his or her own purpose. In the employment context, cat's paw liability may be found where a biased subordinate employee uses his or her superiors to unwittingly carry out his or her own discriminatory motive. The cat's paw theory of liability could apply even where the decision maker had no knowledge of the subordinate's discriminatory intent or, in the extreme, where the decision maker is wholly unaware of the affected employee's membership in a protected class. Procedurally, the cat's paw theory will arise at the third and final step of the *McDonnell Douglas* burden-shifting framework, as a way for a plaintiff to establish that an employer's purportedly non-discriminatory reason for an adverse employment action was pretextual.[4]

Judge Posner of the Seventh Circuit appears to have been the first to use the term "cat's paw" in an employment discrimination case, in an appeal decided in 1990. In *Shager v. Upjohn Company*,[5] the plaintiff alleged that he was terminated because of his age in violation of the ADEA. There was evidence that the plaintiff's direct supervisor, Lehnst, had discriminated against the plaintiff by giving him less profitable assignments as a sales representative and by portraying the plaintiff in a negative light to the company's "Career Path Committee," which was responsible for personnel decisions.

The Career Path Committee ultimately terminated the plaintiff's employment for performance reasons, and there was no evidence that any member of that committee was biased against older workers or knew of Lehnst's discriminatory animus. For that reason, the District Court had granted summary judgment in the defendant employer's favor. The Seventh Circuit reversed, finding that questions of fact existed regarding the extent to which the Committee relied on information that Lehnst provided. "A committee of this sort . . . is apt to defer to the judgment of the man on the spot. . . . If it acted as the conduit of Lehnst's prejudice – his cat's paw – the innocence of its members would not spare the company from liability."[6]

The cat's paw theory of liability could apply even where the decision maker is wholly unaware of the affected employee's membership in a protected class.

Differing Standards Emerge

Most Circuit Courts have recognized the cat's paw theory of liability since the Seventh Circuit's *Shager* decision. However, disagreement has developed regarding the strength of the nexus between a subordinate's improper motive and an adverse employment action taken in order to impute a subordinate's bias to the employer. Three different views have emerged. Some courts have adopted a lenient standard requiring that the plaintiff establish only that the biased subordinate "may have influenced" or "played a role" in the decision-making process. The courts applying this standard include the First, Third, and Sixth Circuits.[7]

At the opposite end of the spectrum is the Fourth Circuit, which applies a much stricter test. In *Hill v. Lockheed Martin Logistics Management, Inc.*, decided in 2005, the Fourth Circuit held that for a subordinate's bias to be imputed to an otherwise innocent employer, a plaintiff must establish that although the biased subordinate had no actual decision making authority, the subordinate was actually the *de facto* decision maker with respect to the adverse action taken against the plaintiff.[8] Under this test, to survive summary judgment, a plaintiff basing discrimination claims on the acts of a subordinate employee "must come forward with sufficient evidence that the subordinate possessed such authority as to be viewed as the one principally responsible for the decision or the actual decision-maker for the employer."[9] It is not sufficient that the biased employee "may have influenced" or "played a role in" the decision-making process. The process must have been such that it was, in fact, the subordinate's decision carried out by those with the proper authority.

A middle ground exists also. Here, the biased subordinate must have "caused" the adverse employment action. This is the standard espoused by Judge Posner in *Shager*, which he later reiterated in the 2004 decision of *Lust v. Sealy*.[10] The Tenth Circuit, in *EEOC v. BCI Coca-Cola Bottling Co. of Los Angeles*, agreed with the Seventh Circuit, stating that a plaintiff must demonstrate that the actions of the biased subordinate "caused" the employment action.[11] The facts of *BCI Coca-Cola* are an extreme example of the circumstances under which the cat's paw theory might apply because the human resources official responsible for terminating the plaintiff's employment worked in a different city, had never met the plaintiff, and was unaware of his race.

The plaintiff in *BCI Coca-Cola* was African-American and had been fired for insubordination because he failed to report for weekend overtime work when ordered to do so by his Hispanic supervisor. The supervisor had a history of treating African-Americans poorly as compared to employees of other races, and in particular other Hispanic employees. The decision to fire the plaintiff was made by a human resources representative in an office 450 miles away, who had never met the plaintiff and had no ill will against him on account of his race. Nevertheless, she based her decision to terminate the plaintiff entirely on the biased supervisor's report of the incident and conducted no investigation of her own. The Tenth Circuit concluded that a jury could reasonably conclude that the supervisor's report of insubordination was tainted by race discrimination. There was no dispute that the plaintiff did not report to work when called in by his supervisor, but the supervisor exhibited racial animus in the past, had let a similar incident involving a Hispanic coworker go unreported, and the defendant changed its explanation for plaintiff's termination during the course of the litigation.[12] This was sufficient to warrant denying summary judgment in the defendant's favor.

If a disparate impact analysis suggests that a RIF will disproportionately impact members of any protected class, the employer should not only be reassessing the criteria utilized in making RIF selections but may wish to drill down to assess whether past discriminatory treatment is a contributing factor.

Cat's Paw Liability and Reductions in Force

In recent years, plaintiffs have sought to apply the cat's paw theory in the context of a RIF. In the only reported Circuit Court decision discussing the theory as it relates to a RIF, the Fifth Circuit affirmed the grant of summary judgment in favor of the defendant.[13] In *Roberson v. Alltel Informational Services*, the plaintiff had been terminated as a part of an eleven employee RIF. The human resources manager responsible for developing the RIF list did not rely on impermissible criteria when creating the list, which was based on objective factors. The plaintiff argued that his direct supervisor, who was not the ultimate decision maker involved in the RIF, previously discriminated against him by refusing him certain skills training and particular assignments, both of which were objective criteria for inclusion in the RIF. However, the trial court found that the plaintiff's supervisor was not responsible for selecting who received particular assignments and that there was no evidence that she was involved in the selection of employees for skills training. Although the District Court and Fifth Circuit rejected the plaintiff's cat's paw theory in that case, the analysis would not preclude another court from imposing cat's paw liability in the context of a RIF under different circumstances.

The plaintiff in *Hawkins v. George F. Cram, Co.*[14] fared better. The District Court denied the employer's motion for summary judgment on Hawkins' age and disability discrimination claims, permitting the plaintiff to pursue her claims under the cat's paw theory because her department supervisor – who was on record as having made age and disability related remarks about the plaintiff – was responsible for evaluating the ability levels of the employees and generating a termination list for her department. In this case, the supervisor had recommended to management that the plaintiff be included in the layoffs, and had discussed her recommendations at the management meeting at which the termination decisions were made. Shortly after the Court denied defendant's motion for summary judgment, the claim was settled for $75,000.

Although no Circuit Court has sustained a cat's paw claim related to a RIF, the Hawkins case demonstrates that the possibility of liability under the cat's paw theory in a RIF context could be a source of problems for employers. Ultimately, the best way for an employer to protect itself from liability as a cat's paw is to fully and independently confirm the facts underlying an employee's termination.[15] Performing such an investigation could be relatively simple if a single employee termination is involved. Some courts have held that cat's paw liability can be avoided simply by asking the employee his or her side of the story.[16] But how extensive an investigation must an employer conduct to reduce the level of risk when it is laying off hundreds or thousands of workers? How can an employer, with no reason to suspect that the decision making process was infected by discrimination, endeavor to verify that none of the employees are being included in the RIF because of the bias of a subordinate supervisor? Existing case law provides little guidance on this question.

Problems of Past Proof

In each of the cases discussed above, the alleged subordinate discrimination occurred fairly contemporaneously with the challenged adverse employment action. Therefore there were no questions about the timeliness of the plaintiffs' cat's paw claims. The cat's paw issue in a RIF is further complicated by the possibility that a far reaching cat's paw claim could be based on events long ago. Especially in those jurisdictions that have adopted a lenient standard, employers must consider how permissive or restrictive a court might be if asked to consider acts of past discrimination that may have recently "influenced" or "played a role" in a RIF decision.

For example, in developing a RIF list, employers often will develop a rating system that is based, at least in part, on criteria such as past performance reviews. Will a court consider evidence that a poor review from five years ago was provided by an allegedly biased supervisor, if that poor review contributed to the low rating that resulted in the employee's inclusion the RIF list? Congress adopted a short limitation period for filing charges of discrimination to encourage employees to raise such claims promptly, and any employer would understandably argue that if an employee thought he or she was discriminated against in the past, the time to complain about it was when it happened.

But consider the case of *Ledbetter v. Goodyear Tire & Rubber Co., Inc.*[17] Ledbetter was a fair pay case, in which the plaintiff based her claim of pay discrimination under Title VII[18] on a series of discriminatory performance reviews that had been made beyond the 180-day period for filing a charge with the EEOC. The Supreme Court rejected her claim, relying on the principle that adverse employment actions that are the later effects of past discrimination are not actionable.

Congress acted quickly to reverse the Supreme Court's *Ledbetter* decision by passing the Lilly Ledbetter Fair Pay Act of 2009.[19] Among other things, the Ledbetter Act changed the law by providing that an unlawful employment practice occurs "when an individual is affected by application of a discriminatory compensation decision or other practice." This legislation expressly requires courts to consider the adverse effects on pay of past discrimination.

As suggested by the title of the new law, the Ledbetter Act appears to be aimed solely at discrimination in compensation. Confirmation of the Act's limited scope also may be inferred from Justice Ginsberg's dissent in the *Ledbetter* case, which drew a clear distinction between pay claims and other types of discrimination.[20] But the breadth of the Lilly Ledbetter Act is already being tested. Attorneys for four female former AT&T employees, who are alleging that they were denied pension benefits in violation of the Pregnancy Discrimination Act, are urging the Supreme Court to consider the timeliness of their claims in light of the Ledbetter Act.[21] It is not unreasonable to predict that a plaintiff soon will argue that Congress's swift reaction to the *Ledbetter* case is a cue to the lower courts to expand their interpretation of Title VII and other anti-discrimination laws in other contexts as well.

A court's consideration of past proof of discrimination under a cat's paw theory could result in serious inequities for employers, who might now be at risk for the conduct of every former supervisor who may have contributed to an employee's poor performance review or his or her failure to obtain skills training or assignments that are utilized as criteria in deciding who is to be the subject of a RIF. In the *Roberson* case, discussed above, the plaintiff argued that his employer's decision to include him in the RIF was the effect of his supervisor's past discrimination. Roberson had no proof to support his claims, and the discrimination that he complained of occurred close enough to the filing of the charge such that timeliness of his claims was not an issue. But Roberson worked for the defendant for 20 years. What if Roberson had alleged, as another plaintiff might, that several years earlier his supervisor denied him training or gave him unfavorable assignments because of his race, and that his lack of training or key assignments contributed to the decision to include him in the RIF? Past performance reviews, training assignments, and other factors often influence determinations of which employees survive a RIF and which do not. It is not unreasonable to conceive of a court permitting a jury to consider whether a past discriminatory review or other past events "played a role," "influenced," or "caused" the employer's decision to lay off the employee.

Conclusion

The possibility of subordinate bias or cat's paw liability imposes additional burdens on an employer. An employer must not only ensure that it acts free from discrimination, but must ensure that its subordinate employees, upon whom it relies, do so as well. An employer is likely to have discharged its obligation if it independently confirmed the facts leading to the adverse employment action. However, trouble may arise for the employer that places blind reliance on information that subordinates provide. The risk to an employer increases exponentially in the context of a RIF because of the number of employees involved and number of prior supervisors whose past actions may contribute to the RIF decision making.

RIFs are implemented in times of declining business conditions and diminished resources, and it is likely to be impractical and unduly burdensome to examine the conduct of every supervisor whose conduct may have contributed to an employee's lower ranking in a RIF decision making analysis. If an employer is seeking a release of claims under the Age Discrimination in Employment Act in connection with a severance offer made to employees subject to a RIF, the employer is obligated to provide the employees with a disclosure document identifying the ages and job titles of those selected and not selected for the RIF, in order to comply with the Older Workers Benefits Protection Act. Because of the need to disclose such information, employees typically will make some form of disparate impact analysis to assess whether older workers may be disproportionately affected by a planned RIF. As a practical matter, because of the risk of cat's paw liability, employers planning a RIF would be well-advised to perform such a disparate impact analysis to determine whether the RIF will disproportionately impact members of any protected class, not just older workers. If the disparate impact analysis suggests that members of any protected class may be adversely affected, the employer should not only be reassessing the criteria utilized in making RIF selections but may wish to drill down to assess whether past discriminatory treatment is a contributing factor.

1 42 U.S.C. § 2000e(b).

2 29 U.S.C. § 630(b).

3 http://en.wikipedia.org/wiki/The_Monkey_and_the_Cat.

4 Under the *McDonnell Douglas* test, a plaintiff must first make a prima facie showing of discrimination. After the plaintiff has established a prima facie case, the burden shifts to the employer to articulate a legitimate, non-discriminatory reason for the adverse employment action. If the employer sustains its burden, the plaintiff has the opportunity to present evidence showing that the employer's explanation is actually a pretext for discrimination. *McDonnell Douglas Corp. v. Green*, 450 U.S. 792 (1973).

5 913 F.2d 398 (7th Cir. 1990).

6 *Id.* at 405.

7 *Cariglia v. Hertz Equip. Rental Corp.*, 363 F.3d 77, 87 (1st Cir. 2004); *Abrams v. Lightolier, Inc.*, 50 F.3d 1204, 1214 (3d Cir. 1995); *Ercegovich v. Goodyear Tire & Rubber Co.*, 154 F.3d 344, 354-55 (6th Cir. 1998).

8 *Hill v. Lockheed Martin Logistics Mgmt., Inc.*, 354 F.3d 277, 286-91 (4th Cir. 2005).

9 *Id.* at 291.

10 383 F.3d 580 (7th Cir. 2004).

11 450 F.3d 476 (10th Cir. 2006). The United States Supreme Court initially granted certiorari in *BCI Coca-Cola* during the 2006-07 term, but dismissed the case just prior to oral argument. *See* 127 S. Ct. 1931 (2007).

12 The defendant had originally told the plaintiff that he was fired for not reporting to work when ordered to do so. Later, the defendant argued that it fired the plaintiff solely for his defiant conduct on the telephone call when his supervisor ordered him to report for work, and not merely his absence. 450 F.3d at 490-91.

13 *Roberson v. Alltel Informational Servs.*, 373 F.3d 647 (5th Cir. 2004).

14 397 F. Supp. 2d 1006 (S.D. Ind. 2005); *see also Cobb v. Syniverse Techs., Inc.*, 359 F. Supp. 2d 1287 (M.D. Fla. 2005) (denying defendant's motion for summary judgment in an age discrimination case in which the plaintiff argued that his employer acted as the "cat's paw" of his biased supervisor when the employer terminated the plaintiff as part of a RIF).

15 A recent decision from the District of Nevada suggests that even an investigation by unbiased decision makers may be insufficient to cleanse a tainted employment action. *See Lanahan v. S. Nevada Health Dist.*, No. 06-cv-01176 (D. Nevada Feb. 17, 2009). In *Lanahan*, the Court wrote: "[T]he decision makers here, while unbiased themselves, took into account factors allegedly tainted by sexism in making an adverse employment decision. The court, of course, recognizes that the incident leading to Lanahan's termination was investigated and acted upon by unbiased decision makers. However, the court cannot ignore evidence that the decision makers also implicitly relied on [a biased supervisor's] disciplinary actions in deciding to terminate Lanahan."

16 *See BCI Coca-Cola*, 450 F.3d at 488.

17 550 U.S. 618, 127 S. Ct. 2162 (2007).

18 Ledbetter also sued under the Equal Pay Act of 1963, Pub. L. No. 88-38, 77 Stat. 56, codified at 29 U.S.C. § 206(d). The District Court granted summary judgment in Goodyear's favor on Ledbetter's Equal Pay Act claim, which was not the subject of the Supreme Court's decision.

19 Pub. L. No. 111-2, 123 Stat. 5 (2009).

20 550 U.S. 618, 127 S. Ct. at 2179 (Ginsberg, J. dissenting) ("[P]ay disparities are . . . significantly different from adverse actions 'such as termination, failure to promote, . . . or refusal to hire.'").

21 *AT&T Corp. v. Hulteen*, No. 07-543 (supplemental brief filed Feb. 12, 2009).

New York Court Lowers Standard for Harassment Claims Under New York City Law

By Jonathan Shiffman

New York City employers should be aware of a January 27, 2009 decision by a panel of the Appellate Division, First Department – *Williams v. New York City Housing Authority*[1] – that substantially lowers the legal threshold for establishing sexual harassment claims under the New York City Human Rights Law ("NYCHRL"). While in the past, most courts have held that the NYCHRL should be construed in the same manner as Federal anti-discrimination statutes, a 2005 amendment to the NYCHRL, the 2005 Civil Rights Restoration Act ("Restoration Act"),[2] cast some doubt on that line of cases, and now Judge Rolando T. Acosta's[3] opinion indicates that such decisions may no longer be good law.

Judge Acosta stated that all harassing conduct based on gender is actionable except for conduct that a "reasonable victim of discrimination would consider 'petty slights and trivial inconveniences.'"

In analyzing a New York City plaintiff's sexual harassment claims under the NYCHRL, Judge Acosta looked to the provisions of the Restoration Act, which stressed that in order to effectuate the NYCHRL's "uniquely broad and remedial purposes," the law is to be construed "liberally," regardless of whether federal or State anti-discrimination laws have been so construed, even if those laws are comparably worded. Thus, Judge Acosta found that NYCHRL "requires an independent liberal construction analysis in all circumstances" and that "interpretations of State or federal provisions worded similarly to NYCHRL provisions may be used as aids in interpretation only to the extent that the counterpart provisions are viewed 'as a floor below which the NYCHRL cannot fall, rather than a ceiling above which the local law cannot rise.'"

Turning to the legal standard appropriate for a sexual harassment claim under the NYCHRL, Judge Acosta found that the federal standard under Title VII was too restrictive. Under Title VII, a sexual harassment plaintiff is required to show that the alleged harassment was "severe and pervasive" in order to state a claim.[4] Judge Acosta rejected this standard on the grounds that it effectively "sanctioned a significant spectrum of conduct demeaning to women." Instead, based on the premise that in order to prove a violation in any discrimination case a plaintiff must prove that she has been treated less favorably than other similarly situated employees because of her protected status, Judge Acosta stated that all harassing conduct based on gender is actionable except for conduct that a "reasonable victim of discrimination would consider 'petty slights and trivial inconveniences.'" Judge Acosta further ruled that the burden is on the employer, not the employee, to prove by means of an "affirmative defense" that the alleged objectionable conduct was no more than a "petty slight" or "trivial inconvenience."

Despite propounding an extraordinarily broad reading of the NYCHRL, Judge Acosta affirmed summary judgment for the employer in the *Williams* case itself. The plaintiff was only able to establish the existence of one set of inappropriate comments, and those comments "were not directed at her, and were perceived by her as being in part complimentary to a co-worker." Thus, Judge Acosta found, no reasonable jury could find that plaintiff suffered anything more than "petty slights or trivial inconveniences." But the court then noted in a footnote that "[o]ne can easily imagine a single comment that objectifies women being made in circumstances where that comment would, for example, signal views about the role of women in the workplace and be actionable. No such circumstances were present here." Thus, Judge Acosta suggested, even a single objectionable workplace comment might be enough to establish liability for sexual harassment under the NYCHRL. This is considerably broader than the standard under Title VII and the New York State Human Rights Law.

Judge Acosta's decision is binding on all New York Supreme Courts within the First Department, including those courts located in the borough of Manhattan. It is not, however, binding on federal courts, and an earlier, November 2008 decision by Judge McMahon in the Southern District of New York expressly preserves the "severe and pervasive" standard for harassment claims under the NYCHRL.[5] In reaching this conclusion, Judge McMahon observed that, in passing the Restoration Act, "the City Council ignored the suggestion that the 'severe and pervasive' requirement be eliminated" and therefore he "decline[d] to change the standard of law when the legislature elected not to do so."

Although Judge McMahon's decision is more favorable for harassment defendants, New York City employers will be unable to avoid State court, and the currently binding *Williams* precedent, if an employment discrimination plaintiff chooses not to bring a Title VII claim (and should the case lack diversity jurisdiction). New York City employers, therefore, should review their anti-discrimination policies to assure that they emphasize zero tolerance for harassment. Although the *Williams* court protests that the NYCHRL is not meant to act as a "general civility code" for employers, the practical import of the decision may be to turn all but the most innocuous off-color comments into grounds for a lawsuit. Thus, so long as *Williams* remains good law, New York City employers must be prepared to propound zero-tolerance anti-discrimination policies and to appropriately discipline those employees who violate them.

1 872 N.Y.S.2d 27 (1st Dept 2009).

2 Local Law No. 85 of City of New York (2005)

3 Judge Acosta previously served as the Deputy Commissioner for Law Enforcement and First Deputy Commissioner of the New York City Commission on Human Rights.

4 *Meritor Savings Bank v. Vinson*, 477 U.S. 57 (1986).

5 *See Gallo v. Alitalia-Linee Aeree Italiane-Societa Per Azoni*, 585 F.Supp.2d 520, 537 (S.D.N.Y. 2008).

International Employment Law

Overview of the Impact of Insolvencies on German Employment Law Issues

By Stephan Grauke and Mareike Pfeiffer

The financial crisis is taking its toll in Germany. For 2009, it is expected that the insolvency rate in Germany will increase by around 17%, threatening about 500,000 jobs.

In the following, we will provide an overview of the impact of German insolvencies on German employment law issues. Insolvencies abroad or, for instance, Chapter 11 filings in the US will not automatically result in an insolvency of a German subsidiary. However, within group companies with foreign subsidiaries and group-wide financing, a Chapter 11 or insolvency filing abroad very often results in an event of default under the local facility tranches, which in turn could result in an insolvency of the German subsidiary.

Basics of German Insolvency Law

If a German company becomes illiquid or overindebted, generally the directors of such company are under an obligation to file for the opening of insolvency proceedings with the local court within a statutory period of three weeks at the latest. The local court determines whether the proceedings are opened or not (the latter will be the case if the assets of the company are unlikely to cover the costs of the proceedings).

Insolvency law facilitates termination of workforce and limits severance payments.

German insolvency proceedings are generally not similar to Chapter 11 proceedings in the US. Rather, in the majority of all cases, the insolvency administrator appointed by the court will try to realize the company's assets by selling them off to third parties and distribute the proceeds to the creditors in accordance with a statutory waterfall. Only in less than 1% of all insolvency cases is the business of the company continued on the basis of a so-called insolvency plan which must be approved by the insolvency court and the majority of the creditors. The insolvency plan may *inter alia* provide for a haircut of the creditors, a debt-to-equity swap, etc. The statutory waterfall under the German Insolvency Code provides that secured creditors (holding pledges over shares in subsidiaries or assets, security assignments, etc.) are compensated outside the insolvency proceedings. Only after satisfaction of the secured creditors is the remainder of the insolvency estate available for distribution to the creditors in accordance with the waterfall. The waterfall provides that first the cost of the insolvency proceedings and payment obligations entered into by the insolvency administrator, such as unsecured loans granted by banks after the opening of insolvency proceedings and contracts entered into by the insolvency administrator, have to be satisfied. The remainder is then available for the unsecured creditors which are paid pro rata of their outstanding amount to the remaining proceeds available for distribution.

The opening of insolvency proceedings results in the power of disposal over, and administration of, the company's assets passing to the insolvency administrator. The insolvency administrator is also the successor to all employer's rights. Insolvency proceedings in Germany are not state-run but rather state-controlled, *i.e.*, they are supervised by the insolvency court with the creditors having certain decision-making powers.

In insolvencies, the Federal Employment Agency covers outstanding salary payments up to three months.

General Impact of an Insolvency on Employment Law

In general, a company remains bound to German employment law even in case insolvency proceedings are opened, *i.e.*, employment contracts as well as shop agreements with the works council (if any) do not terminate automatically due to the insolvency. The same applies to statutory employment law and collective bargaining agreements with labor unions with the consequence being that the insolvent company is not entitled to terminate any employment agreement without observing the German Protection against Unfair Dismissal Act (*Kündigungsschutzgesetz*), which requires (i) an operational reason, (ii) a behavior-based reason, or (iii) a reason based in the person for a valid termination under this Act. The opening of insolvency proceedings itself does not constitute a reason for termination within the meaning of the Protection against Unfair Dismissal Act. However, terminations may be justified in case of the closure of an entire plant or a part of it.

Despite the above, there are a number of qualifications and implications following an insolvency, including the shortening of termination periods, termination facilitations, severance payments, salaries, company pension schemes and partial retirement agreements.

Termination Periods and Termination Facilitation

In Germany, the statutory notice period for termination – dependent on the length of service of each employee – between four weeks to the 15th or to the end of each calendar month and seven months to the end of a calendar month applies. Longer termination periods can be (and generally are) agreed upon in individual contracts with employees. In case of insolvency, notice periods for terminations of employment contracts are uniformly shortened by mandatory law to a maximum of three months to the end of a calendar month unless a shorter notice period applies. This principle also applies to employees who cannot be terminated ordinarily by observing the applicable notice period, *e.g.*, because ordinary termination is excluded by a shop agreement or by a collective bargaining agreement.

Additionally, the German Insolvency Code provides for a termination facilitation in case the insolvency administrator intends a change in operations and therefore agrees with the works council (if any) on a reconciliation of interest agreement (*Interessenausgleich*) which includes a list naming the employees who are to be terminated. As a consequence of such list, the possibilities for an employee to succeed in labor court with an unfair dismissal claim are substantially reduced.

Termination facilitations also apply to shop agreements (*e.g.*, the granting of a Christmas bonus, the reimbursement of expenses). In case insolvency proceedings are opened, the insolvency administrator and the works council will consult about a reduction of the benefits granted to the employees by the works agreement. In case the parties do not come to a mutual understanding, the shop agreement is generally terminable with a notice period of three months.

Impact on Severance Payments Agreed in a Social Plan

In case a works council exists at a German enterprise, the employer is not entitled to implement a change in operations (*e.g.*, plant closure, material changes in the operational organization or working methods) without agreeing with the works council on a reconciliation of interest agreement defining the nature and scope of the intended measure and on a social plan (*Sozialplan*) defining severance payments and other benefits for compensation of the employees' disadvantages. Severance payments are usually calculated in consideration of the length of service of each employee and his or her age and are not limited in amount. Negotiations on the reconciliation of interest agreement and the social plan may last a few weeks or even several months. However, the employer is not entitled to execute the intended change in operations prior to reaching an agreement with the works council.

These principles generally also apply in case insolvency proceedings are opened. However, the German Insolvency Code provides for a provision accelerating the negotiation procedure and limits the severance package for all employees: the total amount of the entire severance package must not exceed (i) 2.5 monthly salaries of all terminated employees and (ii) 1/3 of the insolvency estate available for distribution to the creditors without a social plan.

In case no works council exists at the insolvent company, there is no legal obligation to pay severance payments at all.

Salary Compensation in Case of Insolvency

In insolvency, the employees may assert outstanding salary and other benefits claims only as so-called ordinary unsecured creditors in the waterfall. Salary and other benefit claims that arise due to work performed after the opening of insolvency proceedings are direct claims against the insolvency estate and must be meet before the proceeds are distributed to the creditors, *i.e.*, salary claims following the opening of insolvency proceedings rank prior to other unsecured creditors in the waterfall.

In case insolvency proceedings are opened, or an application to open insolvency proceedings is refused due to lack of assets, the Federal Employment Agency (a state institution) covers the outstanding last three monthly salary payments prior to the opening of insolvency or the refusal of a respective application. Claims for reimbursement of the amounts paid by the Federal Employment Agency rank as normal unsecured claims in the waterfall.

Impact on Company Pension Schemes

According to German law, company pension schemes (executed via direct pension commitments, direct pension insurance or a relief or pension fund) must be insured against the insolvency of the employer with the Mutual Pension Assurance Association (*Pensions-Sicherungsverein auf Gegenseitigkeit*). In case insolvency proceedings are opened or the application to open insolvency proceedings is refused due to lack of assets, the Mutual Pension Assurance Association assumes the liabilities for (i) current pension payments, and (ii) pension expectancy rights vested according to the German Company Pension Act (*Betriebsrentengesetz*).

The Mutual Pension Assurance Association is entitled to file for payment under such claims with the insolvency administrator as unsecured creditor.

Impact of Insolvency on Partial Retirement and Working Time Accounts

Advanced performance claim accounts must be insured against insolvency. This commitment primarily includes advanced performance claim accounts based on agreements on part-time employment prior to retirement ("Partial Retirement Agreements") and agreements on working time accounts.

The commitment to take out insolvency insurance for a working time account applies (i) to the extent there is no claim for compensation of the outstanding salaries with the Federal Employment Agency (which is generally not the case), (ii) the accrued value of an advanced performance claim account exceeds an amount of EUR 6,405 (East Germany) or EUR 7,560 (West Germany), and (iii) the advanced performance claim accounts will remain in force for a period exceeding 27 calendar months. Advanced performance claim accounts due to Partial Retirement Agreements must be insured against insolvency in case the value of the advanced performance claim account for the respective participating employee amounts to at least three times his or her monthly gross salary paid under the Partial Retirement Agreement.

Even if there are several restructuring options for a company, the impact of insolvency, also with respect to employment law issues, should be considered in time. However, the specific consequences as well as advantages and disadvantages must be examined in each individual case.

The Department of Labor Implements New FMLA Regulations

By Lawrence J. Baer and Courtney P. Fain

Introduction

On January 16, 2009, the United States Department of Labor ("DOL") implemented new regulations interpreting and enforcing the Family and Medical Leave Act ("FMLA"). The regulations both clarify existing regulations and set forth new regulations necessitated by the passage of the National Defense Authorization Act ("NDAA"), which amended the FMLA to provide leave related to the military service of an employee's family members.

FMLA Background

The FMLA was enacted in 1993 for the purpose of helping employees balance the demands of the workplace with the needs of their families. As enacted, the FMLA guarantees "eligible" employees up to 12 weeks of unpaid leave in any 12-month period for any of the following reasons: (1) the birth of a child; (2) the placement of a child for adoption or foster care; (3) to care for a spouse, child, or parent with a serious health condition; or (4) because the employee has a serious health condition. An "eligible employee" is an employee of a covered employer who has been employed for at least 12 months and 1,250 hours of service during the 12-month period. Upon return, an employee is entitled to be restored to the same or equivalent position. Further, during FMLA leave, an employer must continue the employee's health benefits.

The passage of the NDAA expanded coverage of the FMLA to families of military personnel in two respects. First, the NDAA extended the availability of 12 weeks of FMLA leave to employees who experience a "qualifying exigency" relating to a family member's service in the National Guard or Reserves. Second, the law created a new category of FMLA leave called "Military Caregiver Leave" or "Covered Servicemember Leave" which entitles eligible employees who are the spouse, child, parent, or next of kin of a "covered servicemember" to 26 weeks of leave during a 12-month period in order to care for a family member injured during military service.

Absent extenuating circumstances, an employer may now require that employees comply with the employer's usual and customary notice and procedural requirements for requesting leave.

In enacting the FMLA, Congress authorized the Secretary of Labor to "prescribe such regulations as are necessary to carry out" the law. The recent revisions to the FMLA regulations are the first such revisions since the initial regulations were implemented in 1995. Below is a summary of some of the more notable revisions to the existing regulations as well as a brief discussion of the new regulations issued in light of the passage of the NDAA.

Revisions to Existing Regulations

Waiver of Rights

The revised regulations specifically provide for an employee's right to settle or release past FMLA claims without DOL or court approval. This clarification is a response to court interpretations that the prior regulations prohibited both retrospective and prospective waivers of FMLA rights. *See Taylor v. Progress Energy*, 493 F.3d 454 (4th Cir. 2007). The clarification now makes clear that employees cannot waive *prospective* rights under the FMLA but may waive pre-existing claims.

Time spent on light duty does not count as FMLA leave. This section further clarifies that an employee's acceptance of a "light duty" assignment while recovering from a serious health condition does not constitute a waiver of the employee's prospective FMLA right to be restored to the position held prior to the commencement of FMLA leave.

Serious Health Condition

As noted above, an eligible employee can take FMLA leave due to a "serious health condition" or that of the employee's parent, spouse, or child. The revised regulations retain the basic definition of "serious health condition" to require inpatient care or continuing treatment and offer clarification as to what constitutes "continuing treatment." First, to qualify as a "serious health condition" involving "continuing treatment," an employee who is incapacitated for more than three consecutive calendar days, absent extenuating circumstances, must: (1) receive treatment two or more times within 30 days of the incapacity; and (2) seek treatment within seven days of the first day of incapacity. The prior regulations provided no guidance as to the time frame in which an employee must seek medical treatment. Second, an employee who takes leave due to a chronic condition requiring "periodic visits" to a health care provider must visit a doctor at least twice a year.

"Periodic visits" was not defined in the prior regulations.

Use of Concurrent Paid Leave with FMLA Leave

While FMLA leave is unpaid, the statute allows for the use of paid leave during any FMLA leave period, either at the employee's discretion or the employer's mandate. The revised regulations now permit an employer to utilize its normal procedures for requesting paid leave to the employee's request to use such leave during the FMLA leave period. This is a significant change from the prior regulations, which provided different procedural requirements based on whether the employee was substituting paid vacation, personal, or sick leave. Now, an employee who chooses to use concurrent paid leave with FMLA leave must follow the terms and conditions applicable to all employees seeking such paid leave.

Awards and Bonuses

An employee returning to work from FMLA leave is entitled to equivalent pay, including bonuses and awards based on specified goals, such as perfect attendance, hours worked or products sold. The prior regulations limited an employer's ability to disqualify employees whose failure to meet certain goals was attributable to FMLA leave. Under the revised regulations, however, an employer can disqualify an employee from receiving a bonus or award if the employee did not achieve a specific goal due to his or her FMLA leave, so long as employees taking non-FMLA leave are treated the same as employees taking FMLA leave.

Notice Provisions

The revised regulations implement several important changes to both employer and employee notice obligations. For employers, the final rule consolidates all requirements into one section. Employers are required to provide employees with: (1) a general notice about the FMLA; (2) an eligibility notice; and (3) a designation notice. The general notice about the rights of employees under the FMLA must be provided both through a poster in a conspicuous place and also directly to the employee, either through a handbook or general notice upon hiring. The eligibility notice must be provided to employees within five business days of their request for FMLA leave, absent extenuating circumstances. This increases the employer's time for providing such notice from the prior rules, which allowed employers only two days to determine an employee's eligibility for FMLA leave. A notice of the employee's rights and responsibilities must also accompany the eligibility notice. Finally, once there is sufficient information to determine whether an employee is eligible, the employer has five business days, absent extenuating circumstances, to provide the employee with either notice that his or her leave has been designated FMLA leave, and setting forth the amount of leave or notice that more information is needed to determine whether the leave qualifies under the FMLA.

The revised regulations specifically provide for an employee's right to settle or release past FMLA claims without DOL or court approval.

Included in the revised regulations are samples of the revised Poster/General Notice (Form WH-1420), revised Notice of Eligibility and Rights and Responsibilities (Form WH-381), and new Designation Notice (Form WH-382) for employers to use.

Under the revised regulations, an employer's failure to comply with the notice requirements or to properly designate an employee's leave as FMLA leave may result in monetary liability only if the employee can show that actual harm resulted from the employer's failure to properly designate FMLA leave. This revision brings the regulations in line with the United States Supreme Court's holding in *Ragsdale v. Wolverine World Wide, Inc.*, 535 U.S. 81 (2002). In that case, the Court invalidated a prior regulation that provided an employer's failure to properly designate FMLA leave necessarily resulted in the leave not counting against the employee's FMLA leave entitlement.

The revised regulations also make several changes to the employee's notice obligations, which will permit employers to anticipate and plan for the requested FMLA leave. Specifically, absent extenuating circumstances, an employer may now require that employees comply with the employer's usual and customary notice and procedural requirements for requesting leave. Failure to comply with the employer's usual procedures for requesting leave may result in the delay or denial of FMLA leave. Notably, an employee must give notice of the need to take FMLA leave due to unforeseeable events "as soon as practicable under the facts and circumstances of the particular case." The former regulations permitted an employee to provide notice within one to two business days after learning of the need for leave, which sometimes resulted in an employee providing notice after the commencement of such leave. This reference has been deleted.

Medical Certification

The revised regulations contain substantive changes that should streamline the process by which employers verify that an employee has a "serious health condition" by allowing employers to obtain more complete medical information. First, the DOL has published two new forms – Form WH-380E and Form WH-380F – that comply with the FMLA and can be used for verifying the serious health condition of employees or their family members. These forms allow health care providers to offer more information as to the nature of the serious health condition than previously permitted. Under the revised regulations, an employer must allow an employee seven days to cure any deficiency in the certification.

While the former regulations prohibited employers from directly contacting an employee's health care provider, the revised regulations permit the employer's health care provider, human resources professional, leave administrator, or management professional, but not the employee's direct supervisor, to contact the employee's health care provider for purposes of authenticating or clarifying information provided on a medical certification form. The employer cannot request more information than is required in the form.

New Regulations Relating to Military Family Leave

Qualifying Exigency Leave

As noted above, the NDAA established a fifth type of FMLA leave which allows eligible employees to take leave, because of a "qualifying exigency" because their spouse, child, or parent is called to active duty. The regulations specify that this leave is not available to family members of active duty members of the Armed Forces; rather, the provisions apply only to members of the Reserves and National Guard.

The regulations provide a list of eight "qualifying exigencies": (1) short-notice deployment; (2) military events and related activities; (3) childcare and school activities; (4) financial and legal arrangements; counseling; (6) rest and recuperation; (7) post-deployment activities; and (8) additional activities that the employer and employee agree qualify as an exigency and further agree to the timing and duration of the leave.

The DOL has published a form entitled "Certification for Qualifying Exigency for Military Family Leave" (Form WH-384) which can be used by employers to verify the exigency.

Military Caregiver Leave

Additionally, the NDAA created an entirely new category of leave, which gives eligible employees 26-weeks in a "single 12 month period" to care for a "covered servicemember." An eligible employee may take leave to care for a "covered service-member" with a "serious injury or illness" incurred in the line of duty for which the active duty service-member is: (1) undergoing medical treatment, recuperation, or therapy; or (2) otherwise in outpatient status; or (3) otherwise on the temporary disability retired list. A "covered servicemember" is a current member of the Armed Forces, the National Guard or Reserves. Importantly, the DOL concluded that the statutory languages of the NDAA does not extend the right to take FMLA to those employees who are providing care to retired (other than those on the temporary disability retired list) or discharged servicemembers.

The NDAA provides that military caregiver leave is available to eligible employees who are the "spouse, son, daughter, parent, or next of kin of a covered servicemember." "Next of kin" is defined as the servicemember's nearest blood relative, other than his or her spouse, parent, son, or daughter. The DOL rejected the recommendation that a person should only be considered eligible as "next of kin" if the injured servicemember's spouse, parent, or children are not available to provide care for the injured servicemember.

An eligible employee cannot take more than 26 weeks of leave in any "single 12-month period." The 12-month period begins on the first day the eligible employee takes the leave and ends 12 months after that date. Military caregiver leave is a one-time entitlement and is applied on a per-covered-servicemember, per-injury basis. If an employee does not use all 26 weeks within the single 12-month period, he or she forfeits the remaining weeks. An eligible employee can take the full 26 weeks, even where he or she previously took FMLA leave during the calendar year.

The DOL has drafted a form entitled "Certification for Serious Injury or Illness of Covered Servicemember for Military Family Leave" (Form WH-385) which can be used by employers to verify the necessity for leave.

Impact on Employers

The revised regulations will have an immediate impact on many employers. Employers will need to revise their FMLA policies to incorporate the changes and will need to ensure that their forms are in compliance with the new regulations. Further, human resource professionals will need to be informed about new and changed obligations under the revised regulations, especially those pertaining to medical certification and notice. Finally, employers may wish to review other policies implicated by the revised regulations, specifically the procedures for requesting paid leave, giving notice that one will be out of the office, and those related to the granting of attendance and other goal-oriented awards.

Garden Leave Clauses In Lieu of Non-Competes

By Briana M. Bunn

For many years, employers in the United Kingdom have included in their employment agreements so-called "garden leave" clauses. Under a "garden leave" clause, the employee promises to give a certain amount of notice to the employer in advance of the employee's resignation from employment. In exchange, the employer does not require the employee to work during the period of the garden leave. The term "garden leave" is based on the quaint idea that the employer pays the employee to stay at home and tend to his or her "garden."

US employers increasingly are including garden leave provisions in their employment agreements. One reason for this is that garden leave clauses have some of the same benefits as non-competition agreements, but perhaps without some of the challenges employers often face in enforcing non-competition agreements. Employers also may realize certain advantages in employee relations as employees may perceive the "optics" of garden leave more favorably than the way in which they perceive the restrictions of non-competition agreements.

Just as with a non-competition agreement, if the employee fails to abide by the garden leave clause, the employer may apply to the appropriate court for an injunction that would enforce the provision. Thus, ideally, the garden leave provision protects the employer against both competition from the employee and/or misappropriation of confidential business information. During the garden leave period, the employee may not work in competition with his or her employer as such conduct would violate the employee's continuing duty of loyalty. Further, because the employee stops reporting to work, the employee no longer can access confidential company records. Finally, any confidential information already in the employee's possession may possibly become stale during the garden leave period.

Under a "garden leave" clause, the employee promises to give a certain amount of notice to the employer in advance of the employee's resignation from employment. In exchange, the employer does not require the employee to work during the period of the garden leave.

Garden leaves also provide a measure of protection to the employer against the employee's solicitation of clients and coworkers. During the garden leave period, the employer may seek to transition the departing employee's duties and client relationships over to other employees. At the same time, because garden leave is paid leave, employers are not faced with the prospect of asking a court to enjoin an employee from pursuing his or her chosen field of endeavor or to prevent an employee from earning a living.

What difference, if any, is there between a garden leave clause and a restrictive covenant accompanied by severance? The most obvious difference is that the employee remains an employee of his former employer during the garden leave period. As noted above, the employee still owes a duty of loyalty to the employer. In addition, courts presumptively will be much more willing to allow an employer to dictate the activities of a current employee than they will a former employee. At the same time the employee will typically continue to be covered by the employer's benefit plans, and receive salary continuation during the garden leave.

In the UK, courts consistently have enforced garden leave provisions. At the same time, UK courts (like US courts) have tended to construe non-competes narrowly and have made enforcement challenging in some jurisdictions. Very few US courts have addressed garden leave clauses. However, those decisions addressing compensation arrangements with restrictions similar to garden leave may provide some guidance. In these cases, courts generally have taken favorable note of the compensation component when conducting the reasonableness analysis that courts must undergo in considering the enforceability of restrictive covenants.

Background

While few reported cases address the enforcement of garden leave clauses, several New York decisions have addressed non-competes containing provisions very similar to garden leaves. In considering whether to grant injunctions enforcing non-competes, courts consider the necessity and reasonableness of the covenants. When a non-compete includes a requirement that the employer continue the employee's salary during the period of the non-compete, courts appear to be much more willing to find the reasonableness balance tipping towards the employer.

Courts in New York have upheld non-competes with so-called "safety net" clauses – provisions providing for payment only in the event that the employee is unable to find alternative employment[1] – as well as non-competes with provisions that are garden leaves in all but name. For example, in *Natsource LLC v. Paribello*, 151 F. Supp. 2d 465, 472 (S.D.N.Y. 2001), the court, in upholding the 30-day notice provision combined with the 90-day non-compete provision, noted the significance of the safety-net payment provision, which made "virtually non-existent [the] concern that Paribello [the former employee] could loose [sic] his livelihood."

In *Lumex, Inc. v. Highsmith and Life Fitness*, 919 F. Supp. 624, 629-36 (E.D.N.Y. 1996), the court upheld the six month restrictive covenant, giving great weight to the employee's full compensation of salary and payment of health and life insurance premiums under the safety-net provision: "In this case, there is a special kind of restrictive covenant, one that compensates a former employee who cannot work because of the terms of the agreement." *See also Maltby v. Harlow Meyer Savage, Inc.*, 633 N.Y.S. 2d 926, 930 (N.Y. Sup. Ct. 1995) (finding the restrictive covenant reasonable "on condition that plaintiffs continue to receive their salaries for six months while not employed by a competitor").

In *Estee Lauder Companies, Inc. v. Batra*, 430 F. Supp. 2d 158, 182 (S.D.N.Y. 2006), the court upheld a restrictive covenant containing a "sitting out" clause. In granting the employer a five month enforcement period (but not the originally requested one year period) of the restrictive covenant, the court found it particularly significant that the former employee-executive was not only entitled to his full salary of $375,000 per year during the "sitting out" period but was also permitted to earn additional compensation from non-competitive work during the period. The court found that the risk to the former employee-executive of a loss of livelihood was mitigated by the continual payments.

Given the costs to the employer of paying salary and benefits during the period of garden leave, the employer must carefully consider and identify the types of employees that warrant a garden leave clause, such as senior executives, key technical employees and employees who have access to confidential information or who control a large book of business.

The Second Circuit, applying New York law, extended the logic even further in *Ticor Title Insurance Co. v. Cohen*, 173 F. 3d 63, 71 (2d Cir. 1999), upholding a six month non-competition agreement even though it did not contain any post-employment payment provision. The Second Circuit found the employee-salesman's annual compensation of $600,000, which had been expressly provided by the employer contingent upon the employee-salesman's agreement to abide by his contractual post-employment restrictions, served the same purpose as the post-employment payments in *Maltby* – to help "alleviate the policy concern that non-compete provisions prevent a person form earning a livelihood." As the former employee-salesman had been provided with "sufficient funds to sustain him for six months," any public policy concern "regarding impairment of earning a livelihood was assuaged."

No Injunction Ordering Involuntary Servitude

A recent garden leave case from Massachusetts raises some issues as to the enforceability of certain types of garden leave clauses in particular circumstances. In *Bear, Stearns & Co v. Sharon*, 550 F. Supp. 2d 174 (D. Mass. 2008), the court denied the employer's motion for a preliminary injunction. The employer based its motion on the former employee-broker's immediate acceptance, upon resignation, of a position with competitor Morgan Stanley, in breach of a garden leave provision with a 90-day notice requirement.[2]

However, the court's analysis reflects that the court focused on the interests of the employee-broker's clients and their need for advice during the economic crisis. The court discussed this concern in connection with its analysis of the "balance of hardships" and the issue of "public policy." The court concluded that monetary damages would be a better alternative if in fact the employee-broker had violated his garden leave clauses, as this solution would ensure that the employee-broker's clients would "not be disadvantaged."[3]

The court's analysis also suggests that the result might have been different had the employer drafted the garden leave provision more narrowly. In *Sharon*, the garden leave provision stated: "Bear Stearns will pay your base salary, during which time you may be asked to perform *all, some or none of your work duties* in Bear Stearn's sole discretion" (emphasis added).[4] The court found that this was not a "simple restrictive covenant against competition" but instead a provision that would force the employee-broker into involuntary servitude: "Because the effect of specific performance in this case would be to require the defendant to continue an at-will employment relationship against his will, it is unenforceable in that manner. . . to give it full effect would be to force Sharon [the employee] to submit to Bear Stearn's whim regarding his employment activity in the near future."[5]

Employers considering garden leave clauses should consider carefully the issue of remedy as discussed in *Sharon*. If the reasoning in *Sharon* governs, a court will not require specific performance of the employment relationship where that means the employee is being required to perform services for the employer involuntarily. Query, however, whether the court would have ruled differently if the contract provision at the heart of the injunction focused simply on the requirement that the employee *refrain* from working for the employer, or for anyone else. One logical approach might be for a court to find that an employee enjoined from performing any services is not engaging in servitude at all, involuntary or otherwise. Alternatively, employers also may wish to include in the employment agreement ordinary non-competition covenants applicable during the period of employment, including the garden leave period. In that case, if the employee violates the garden leave provision by competing with the employer, the employer may seek to enforce the restrictive covenants against the employee rather than the garden leave provision. In that scenario, the employer also should include a strong severability or "blue pencil" clause in the employment agreement.

Practical Considerations

First and foremost, given the costs to the employer of paying salary and benefits during the period of garden leave, the employer must carefully consider and identify the types of employees that warrant a garden leave clause, such as senior executives, key technical employees and employees who have access to confidential information or who control a large book of business. The employer should tailor the garden leave provision to these specific workers.

In determining the proper duration of the garden leave, the employer should consider the individual employee's role and level of knowledge as well as which particular interests the employer wishes to protect. As mentioned earlier, in the US, employers thus far have generally favored 30, 60 or 90 day provisions and generally have not reached beyond a six month limitation period.[6]

Once an employer has made these determinations, the employer should seek to ensure that the employment agreement containing the garden leave provision contains the following: (1) a clause allowing the employer to place the employee on garden leave; (2) a statement of the employer's right to exclude the employee from the office or workplace and preclude the employee from contact with customers, clients and confidential information; and (3) a provision prohibiting the employee from working for another employer during the term of the agreement. If the employer wishes to reserve the right to require the employee to perform services during the period of garden leave, the employer should be aware that such a clause may make enforcement more difficult, as the *Sharon* case demonstrates. Alternatively, to avoid the result in *Sharon*, employers may wish to make clear in the garden leave provision that the employee will not be required to perform any services during the garden leave period. The employer also may wish to include restrictive covenants applicable during the entirety of the employment period, including the garden leave.

While some plaintiffs have argued that employment exclusion may result in difficulty in resuming work due to the atrophy of skills, New York courts have rejected such arguments.[7] Given the limited guidance on garden leave clauses from US courts, employers may wish to proceed with additional caution and include provisions permitting the employee to practice his or her skills during the garden leave period by engaging in limited work with tasks or clients that would not benefit a future, competitive employer. The employer also may wish to allow for participation in select continuing education opportunities presented by the employer and outside vendors.

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1 While at first blush such safety net clauses may seem more appealing to employers, as there is a possibility that the employer will not have to internalize the costs, such safety net provisions often require ongoing monitoring of the former employee, which can end up being time-consuming and expensive.

2 *Id*. at 176.

3 *Id*. at 178-79.

4 *Id*. at 176.

5 *Id*. at 178-79.

6 *See also Estee Lauder Companies, Inc.*, 430 F. Supp. 2d at 182 (cutting down the "sitting out" period from one year to five months).

7 *See, e.g., Natsource LLC*, 151 F. Supp. 2d at 472 (dismissing commodity broker's argument that a three month sitting out period would render him unemployable within the industry). *But see Sharon*, 550 F. Supp. 2d at 178 (noting that an injunction would "result in a loss of professional standing" for the broker).

First Appellate Decision in ERISA Excess Fee Case; Significant Victory for Plan Fiduciaries

By Millie Warner

The U.S. Court of Appeals for the Seventh Circuit recently became the first appellate court to address the duties of ERISA plan fiduciaries to control fees charged to plan participants. On February 12, 2009, the Seventh Circuit ruled in *Hecker v. Deere & Co.*, – F.3d –, 2009 WL 331285 (7th Cir. Feb. 12, 2009), affirming the district court's dismissal of Plaintiffs' claims. In doing so, the Seventh Circuit reached three important holdings:

- ERISA does not require the sponsor of a 401(k) plan to disclose to participants that the plan's investment advisor shares revenue with an affiliated plan trustee;
- nothing in ERISA prohibits a fiduciary from selecting funds from one management company, or requires a fiduciary to scour the market to find the cheapest funds; and
- merely "playing a role" in the selection of funds to be offered in a plan is not enough to transform an entity into a fiduciary.

This decision is important not only because it is the first appellate decision in an excessive fee case under ERISA, but also because it rejected several theories commonly advanced by plaintiffs concerning allegedly improper "revenue sharing" and "excessive fees" under ERISA.

Background On Excessive Fee Litigation

In "excessive fee" cases under ERISA, plaintiffs usually allege that plan fiduciaries failed to properly protect against excessive fees paid by plans and their participants for mutual funds or other investments and also failed to properly disclose revenue sharing between service providers. The first "excessive fee" case was filed in 2006, and since then several such cases have been filed. Since this type of case became popular, many lower courts have denied pre-discovery motions to dismiss.[1]

Facts of *Hecker v. Deere & Company*

Deere & Company ("Deere") sponsored two 401(k) plans (the "Plans"). 2009 WL 331285 at *1. Fidelity Management Trust Company ("Fidelity Trust") served as the directed trustee and recordkeeper for the Plans, and also advised Deere on what investment options to offer under the Plans, although Deere made the final determination. *Id.* Fidelity Research Company ("Fidelity Research") served as the investment advisor for the Fidelity mutual funds offered as investment options under the Plans. *Id.* at *2.

Each Plan offered a wide array of investment options. The menu included 23 different Fidelity mutual funds, two investment funds managed by Fidelity Trust, a Deere stock fund, and a Fidelity-operated facility called "BrokerageLink," which gave participants access to approximately 2,500 additional mutual funds managed by different companies. *Id.* at *2. Each fund included within the Plans charged a fee to the individual accounts based on the percentage of assets invested in the fund. *Id.* at *2. Fidelity Research, as the investment adviser, shared some of the fees received by the mutual funds with Fidelity Trust, and Fidelity Trust in turn compensated itself for the trustee and record-keeping services it provided through those shared fees, rather than through a direct charge to Deere for its services as trustee. *Id.* at *2.

Nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund.

Though "distressed primarily by the fee levels," Plaintiffs claimed not only that the fees charged by the funds were excessive, but that there was an "impermissible lack of transparency in the fee structure" because of the absence of any disclosure of the sharing of the fees charged by the mutual funds. *Id.* Under Plaintiffs' theory, the revenue sharing relationship between Fidelity Research and Fidelity Trust caused a "lack of transparency" in the fee structure, because "the mutual fund fees were devoted not only to the (proper) cost of managing the funds, but also to the (improper) cost of administering Deere's 401(k) plans." *Id.* Accordingly, Plaintiffs alleged that Deere violated its fiduciary duties under ERISA by providing investment options that required the payment of excessive fees and costs and by failing adequately to disclose the fee structure to plan participants. *Id.* According to Plaintiffs, this constituted a breach of ERISA § 403(c)(1), which provides that the "assets of plan shall never inure to the benefit of the employer, and shall be held for the exclusive purposes of providing benefits to participants . . . and defraying reasonable expenses of administering the plan," and ERISA

§ 404(a)(1), which requires plan fiduciaries to discharge their duties "solely in the interest of the participants and beneficiaries.

Plaintiffs also alleged that Fidelity Trust and Fidelity Research "functional fiduciaries," and thus were liable under ERISA § 502(a) for the same fiduciary breaches as Deere. *Id.* at *1.

Critical to plaintiffs' case was the proposition that Deere and Fidelity had a duty to disclose the revenue sharing arrangement. The Seventh Circuit held that there was no such requirement under ERISA.

District Court Opinion

The district court granted the motions to dismiss of all three defendants. 496 F. Supp. 2d 967 (W.D. Wis. 2007).

The district court dismissed the disclosure claim on the pleadings on the ground that because ERISA's "[d]isclosure requirements are generally limited to those expressly prescribed by the statutory language of ERISA," Deere's disclosures in its summary plan description ("SPD"), annual report and financial disclosures fully complied with ERISA's statutory and regulatory requirements. *Id.* at 974.

The district court dismissed the excessive fee claim based on ERISA's "safe harbor" provision, ERISA § 404(c). In effect, the district court held that all required disclosures were provided by the SPD and prospectuses so that the safe harbor's disclosure requirement in 29 C.F.R. § 2550.404c-1(b)(2)(B)(1)(v) & (2)(i) was satisfied; that receipt of "additional non-prescribed information" would not enhance participant investment decisions; and that because participants could invest in more than 20 mutual funds with access to "more than 2500 others," if "participants incurred excessive expenses, those losses were the result of participants exercising control over their investments within the meaning of the safe harbor provision." *Id.* at 975-76.

The district court, finding that Deere had not breached any duty, dismissed the claims against Fidelity Research and Fidelity Trust without determining the scope of their fiduciary duties, if any. *Id.* at 976.

Seventh Circuit Opinion

The Seventh Circuit affirmed the district court, but on the basis of different reasoning.

Dismissal of the Fidelity Defendants

First, the Seventh Circuit held that Plaintiffs failed to state a claim for breach of fiduciary duty against Fidelity Trust and Fidelity Research because, as to the claims at issue, based on the facts alleged, neither was a functional fiduciary. 2009 WL 331285 at *7. Although Fidelity Trust was involved in the selection of the investment options for the Plans, the Trust Agreement gave Deere, not any of the Fidelity entities, the final authority over which investment options to include in the Plans. *Id.* The Court held that, as with a lawyer or accountant who may advise plan fiduciaries, "[m]erely 'playing a role' or furnishing professional advice" is insufficient to confer fiduciary status. *Id.* Thus, because the Fidelity entities did not have "final authority" in the selection of funds, they were not subject to fiduciary duties with respect to the selection of the Plans' investment options. *Id.* at *8.

The Seventh Circuit also rejected Plaintiffs' argument that the Fidelity entities exercised discretion over "plan assets" insofar as determining how much revenue Fidelity Research would share with Fidelity Trust. *Id.* The Court, however, held that "[o]nce fees were collected from mutual fund assets and transferred to one of the Fidelity entities, they became Fidelity's assets, not assets of the Plan." *Id.*

Dismissal of Revenue Sharing Claim Against Deere

The Seventh Circuit next turned to the two claims against Deere based on Deere's alleged breach of fiduciary duty (i) by failing to inform participants of the revenue sharing between the Fidelity entities; and (ii) by imprudently agreeing to limit the investment options to Fidelity Research funds and, therefore, offering investment options with excessively high fees. *Id.*

As the Seventh Circuit pointed out, "critical to plaintiffs' case is the proposition that Deere and Fidelity had a duty to disclose the revenue sharing arrangement." *Id.* The Seventh Circuit held that there was no such requirement under ERISA. *Id.* at *9. Although Plaintiffs felt "misled because the SPD" and other documents "left them with the impression that Deere was paying the administrative costs of the Plans," when, in fact, the participants were paying those costs through the revenue sharing system, participants were told about the total fees imposed by the various mutual funds, and were free to direct their dollars to lower-cost funds if that was what they wished to do so. *Id.* "How Fidelity Research decided to allocate the monies it collected" (a total about which the participants were fully informed) was not something that ERISA required at the time to be disclosed. *Id.* The "total fee, not the internal, post-collection distribution of the fee, is the critical figure for someone interested in the cost of a certain investment." *Id.* In sum, Plaintiffs' revenue sharing disclosure allegations failed to state a claim against the plan sponsor.

Dismissal of Excessive Fees Claim and Limited Funds Claim

The Seventh Circuit easily affirmed the dismissal of Plaintiffs' claims based on allegations that Deere violated its fiduciary duties by selecting investment options with excessive fees. The Court found that there was "no room for doubt" that the Plans offered a sufficient mix of investments for the participants, with a wide range of expense ratios, ranging from .07 percent to just over 1 percent. *Id*. at *10. "Importantly, all of these funds were also offered to investors in the general public, and so the expense ratios necessarily were set against the backdrop of market competition." *Id*. Nothing in ERISA requires every fiduciary to "scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems)." *Id*.

Nor did Deere act improperly to limit the investment options to Fidelity mutual funds. No statute or regulation prohibits a fiduciary from selecting funds from one management company, and there is nothing that requires plan fiduciaries to include any particular mix of investment vehicles in a plan. *Id*. ERISA requires fiduciaries to behave like a prudent investor under like circumstances, and "many prudent investors limit themselves to funds offered by one company and diversify within available investment options." *Id*. Significantly, the Seventh Circuit suggested that the allegation based on Deere's restricting the investment options to Fidelity funds appeared to bear more on a "plan design" question, which would not implicate any fiduciary duties. *Id*. This portion of the Seventh Circuit's decision suggests another line of defense against similar claims.

ERISA 404(c) Defense

As an alternative ground for dismissal of the claims, the Seventh Circuit agreed that ERISA Section 404(c) operated as a safe harbor precluding Plaintiffs' claims.

The safe harbor provided by ERISA Section 404(c) is an affirmative defense to a claim for breach of fiduciary duty under ERISA. *Id*. at *12. In their complaint, Plaintiffs "chose to anticipate" this defense, and provide specific reasons why the defense did not apply, including that defendants had failed to provide participants with all material information with which to make decisions because they failed to disclose revenue sharing and that the alleged selection of mutual funds with excessive fees was not the type of conduct falling within the protection of the safe harbor. *Id*. Although a court should not normally dismiss claims under Rule 12(b)(6) on the basis of an affirmative defense, by anticipating this defense, Plaintiffs "put it in play", thus rendering it fair game at the motion to dismiss stage. *Id*.

With respect to Plaintiffs' first argument, the Seventh Circuit noted that it already had concluded that revenue sharing arrangements did not constitute material information for a participant's investment decision as a matter of law and did not have to be disclosed. *Id*. at *13. As to the second issue on fund selection, the Seventh Circuit concluded that it need not reach that issue. "Even if Section 404(c) does not always shield a fiduciary from an imprudent selection of funds, it does protect a fiduciary that satisfies the criteria of Section 404(c) and includes a sufficient range of options so that participants have control over the risk of loss." *Id*. In this case, the Plans offered a broad range of options with a widely ranging level of fees. *Id*. at *14. Thus, as a matter of law, any allegations that these options did not provide participants with a reasonable opportunity to meet the goals of the Section 404(c) regulations (see 29 C.F.R. § 2550.404c-1) or control the risk of loss was "implausible." *Id*. "Given the numerous investment options, varied in type and fee," none of the defendants could be held responsible for those investment choices made by the participants. *Id*.

Advice for Fiduciaries

First, while *Hecker* clearly represents a significant victory for plan fiduciaries, employers and fiduciaries should be aware that this victory was won under the law as it existed in 2006, before the Department of Labor issued new proposed regulations on expense and revenue sharing disclosure. As discussed in *Hecker*, in response to complaints about fee disclosures, the Department of Labor proposed extensive fee disclosure regulations on December 13, 2007.[2] Final regulations were anticipated to be effective January 1, 2009, but are presently on hold under the new Presidential administration. Employers will need to comply with these new regulations when they are finalized and become effective, and also may be subject to additional legislation that has been proposed.

Employers also should note that central to the Seventh Circuit's decision was an endorsement of plan structures that included multiple mutual funds in the base option available to participants and a portal for individual investment options. Plan sponsors may wish to review their investment options in light of *Hecker* and offer a diversified range of options. In addition, to the extent that a 401(k) plan does not have an investment portal, plan sponsors and administrators should consider addition of such an optional investment vehicle, if practical.

Finally, as discussed in *Hecker*, Section 404(c) of ERISA limits fiduciary liability for certain investment losses in participant-directed account plans if certain requirements are met, including the requirement that the plan offers a diversified assortment of investments from which plan participants may choose. Fiduciaries should review all of the requirements of, and ensure compliance with, ERISA §404(c) as a preventative measure to decrease the potential for investment loss claims.

1 *See George v. Kraft Foods Global, Inc.*, No. 06-cv-798-DRH, 2007 WL 853998 (S.D. Ill. Mar. 16, 2007) (denying motion to dismiss, motion to strike, or, in the alternative, motion for a more definite statement); *Spano v. The Boeing Co.*, No. 06-cv-743-DRH, 2007 WL 1149192 (S.D. Ill. Apr. 18, 2007) (denying motion to dismiss); *Kanawi v. Bechtel Corp.*, No. 06-cv-005566 (N.D. Cal. May 15, 2007) (same); *Taylor v. United Technologies Corp.*, No. 3:06cv1494, 2007 WL 2302284 (D. conn. Aug. 9, 2007) (dismissing breach of fiduciary duty claim relating to nondisclosure of revenue sharing agreements but allowing breach of fiduciary duty claim based on excessive fees to proceed); *Waldbuesser v. Northrop Grumman*, No. 06-06213 (C.D. Cal. May 21, 2007) (dismissing several of the defendants, including the Board of Directors, but allowing claims to proceed against other defendants).

2 The proposed rules are available at: http://www.dol.gov/federalregister/PdfDisplay.

New York Enacts Laws Regarding the Employment of Individuals with Criminal Conviction Records

By Amanda G. Burnovski and Elisheva M. Hirshman

When making hiring or other employment decisions, employers are often faced with the issue of whether they may or may not consider the criminal conviction history of an applicant or employee. In New York, Article 23-A of the New York Correction Law ("Article 23-A"),[1] aimed at encouraging the employment of individuals who have been convicted of criminal offenses, sets forth certain requirements governing the employment of such individuals. The New York State Legislature recently enacted four new statutes, all of which are now in effect, which impose additional requirements on employers to carry out the goals of Article 23-A. Three of these statutes impose additional notice requirements on employers regarding the rights of individuals – either applicants or employees – with criminal convictions. The fourth statute encourages employers to employ or retain individuals with a history of criminal convictions by granting employers additional protection against negligent hiring and retention claims.

This article summarizes the relevant sections of Article 23-A and these new statutes, and provides specific suggestions employers may wish to consider with regard to these new obligations.

Background

Article 23-A governs the employment of persons previously convicted of one or more criminal offenses. In relevant part, § 752 of Article 23-A provides: "No application for . . . employment, and no employment held by an individual, . . . shall be denied or acted upon adversely by reason of the individual's having been previously convicted of one or more criminal offenses . . . unless: (1) there is a direct relationship between one or more of the previous criminal offenses and the specific . . . employment sought or held by the individual; or (2) the . . . granting or continuation of the employment would involve an unreasonable risk to property or to the safety or welfare of specific individuals or the general public."[2] Thus, under this law, employers who employ ten or more people cannot refuse to hire an applicant for employment or take any adverse employment action against a current employee on the basis of the applicant or employee's prior criminal conviction, unless either of the two tests specified above from § 752 are satisfied.

An employer who wishes to take any adverse employment action against an applicant or employee based on the applicant or employee's prior criminal conviction must first evaluate the following eight factors to determine if a direct relationship exists between the prior conviction and the employment position, or whether the employment of such an individual would pose an unreasonable risk to the safety and welfare of specific individuals or the general public: (1) New York's public policy encouraging the employment of persons previously convicted of one or more criminal offenses; (2) the specific duties and responsibilities necessarily related to the employment sought or held by the person; (3) the bearing, if any, the criminal offense for which the person was previously convicted will have on his fitness or ability to perform one or more such duties or responsibilities; (4) the time which has elapsed since the occurrence of the criminal offense; (5) the age of the person at the time of occurrence of the criminal offense; (6) the seriousness of the offense; (7) any information produced by the person, or produced on his behalf, in regard to his rehabilitation and good conduct; and (8) the legitimate interest of the employer in protecting property, and the safety and welfare of specific individuals or the general public.[3] At the request of any applicant who has previously been convicted of one or more criminal offenses and who has been denied employment by an employer, the employer must provide a written statement providing the reasons for the denial of employment.[4] An employer may be subject to liability for failing to comply with the requirements of Article 23-A set forth above.[5]

Additional Notice Requirements Imposed on Employers

Effective February 1, 2009, employers are subject to new requirements relating to the notification of applicants and employees with prior criminal convictions of their rights under Article 23-A and related laws.

Employers Must Post Article 23-A

Under the recently amended New York Labor Law § 201-f, all employers *must* post a copy of Article 23-A, as well as copies of any regulations promulgated pursuant to Article 23-A relating to the employment of individuals with prior criminal convictions, "in a visually conspicuous manner" accessible to all employees.[6] Prior to February 1, 2009, there was no obligation on employers to post Article 23-A or related regulations.

Notice To Individuals Subject To Background Checks And/Or Investigative Consumer Reports

The New York State Legislature amended the New York Fair Credit Reporting Act and the New York General Business Law, both effective as of February 1, 2009, to require that employers provide certain applicants or employees with a copy of Article 23-A in two circumstances.

First, in addition to the rule previously in effect that employers must obtain authorization from an applicant or employee approving an employer's request to obtain an investigative consumer report on the applicant or employee,[7] under the newest amendment, an employer who requests such a report must also provide the subject of this report with a copy of Article 23-A.[8] The Fair Credit Reporting Act defines "investigative consumer report" as a "consumer report or portion thereof in which information on a consumer's character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on or with others with whom he is acquainted or who may have knowledge concerning any such items of information."[9]

Second, and similarly, under the newly amended New York General Business Law, when an employer conducts a background check through a consumer reporting agency, and the report received by the employer contains criminal conviction information, the employer is now obligated to furnish the individual at issue – the employee or applicant – with a "printed or electronic copy" of Article 23-A.[10] Prior to the time of this amendment, there was no obligation on the employer to provide such an employee or applicant with Article 23-A. The term "consumer reporting agency" means any person who regularly engages "in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports or investigative consumer reports to third parties."[11]

Negligent Hiring or Retention Claims

On September 4, 2008, an amendment to the New York Human Rights Law was signed into law which extends additional protection to employers who employ individuals with criminal records from negligent hiring and retention claims.[12] This amendment went into effect immediately upon enactment. It creates a "rebuttable presumption in favor of excluding from evidence the prior incarceration or conviction of any person, in a case alleging that the employer has been negligent in hiring or retaining an applicant or employee. . . " if an employer – after learning about an applicant or employee's past criminal conviction history – "has evaluated [the Article 23-A] factors. . . and made a reasonable, good faith determination that such factors militate in favor of hire or retention of that applicant or employee."[13] Under the new law, if an employer evaluates an applicant or employee's criminal history pursuant to Article 23-A and decides in good faith to hire or continue to employ that individual, then there is a presumption that the conviction should be excluded from evidence in a suit against the employer claiming the employer negligently hired or retained this individual.

Impact of New Laws

New York employers should familiarize themselves with these new laws and review and revise their employment policies and practices to ensure compliance. Employers must insure that a copy of Article 23-A is posted in a visually conspicuous and accessible location, such as a pantry or break room. Additionally, employers must be prepared to provide applicants and employees with copies of Article 23-A in the event that an investigative consumer report is conducted or a background check indicates a criminal history. Employers also should consider having individuals furnished with a copy of Article 23-A acknowledge receipt in writing.

Finally, employers considering hiring or continuing to retain an individual with a criminal history should engage in an evaluation of the individual using the test and eight factors set forth in § 752 and § 753 of Article 23-A, respectively. Such evaluations should be in writing and maintained, and should specifically reference the language provided in the statute. As intended by the new law, these written evaluations may be used by employers to create certain rebuttable presumptions against potential claims of negligent hiring or retention of employees with criminal conviction histories.

Employers may wish to consult counsel prior to effectuating any of these recommendations so as to confirm best practices.

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1 N.Y. Correct. Law. §§ 750 - 55.

2 N.Y. Correct. Law. § 752.

3 N.Y. Correct. Law. § 753.

4 N.Y. Correct. Law. § 754.

5 For private employers, the provisions of the article are enforceable by the New York State Division of Human Rights.

6 N.Y. Lab. Law § 201-f.

7 N.Y. Gen. Bus. Law § 380-c(a). Under the law, if the applicant "refuses to authorize the procurement or preparation of an investigative consumer report, the prospective . . . employer may decline to grant . . . employment on the grounds that the applicant refused to execute such authorization." N.Y. Gen. Bus. Law § 380-c(d).

8 N.Y. Gen. Bus. Law § 380-c(b).

9 N.Y. Gen. Bus. Law § 380-a(d).

10 N.Y. Gen. Bus. Law § 380-g(d).

11 N.Y. Gen. Bus. Law § 380-a(d).

12 N.Y. Exec. Law § 296.

13 *Id.*

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